Remuneration scheme for directors

This ruling concerned the nullity of a resolution to amend the bylaws of a Spanish corporation with reference to directors' remuneration within the framework of litigation between a textile company and two shareholders who challenged a corporate resolution, on the grounds that the article being amended does not establish a compensation system for directors in breach of Art. 217 of the Corporate Enterprises Law.

Articles in question

Article 217.2 of the Corporate Enterprises Law states that "the compensation system established will determine the item(s) of the remuneration to be received by directors in their capacity as such (...)". Article 28 of the corporate bylaws, to which this ruling refers, says that "[t]he board shall be remunerated, said remuneration comprising a fixed amount of money for services rendered, to be determined each year by the General Meeting of shareholders. "

First and second instance

The hearings at first and second instance upheld the application, deeming that Art. 28 of the bylaws violated Article 217 of the Corporate Enterprises Law, as it did not stipulate a specific compensation system and that the reference to the annual determination by the General Meeting was "vague" and "inaccurate".

Civil Chamber of the Supreme Court

The Civil Chamber of the Supreme Court first examined the purpose of the obligation to establish a system of remuneration provided in the Art. 217 of the law. It established that the main purpose is to encourage corporations to give as much information as possible to shareholders in order to help them monitor the actions of directors and prevent those directors' economic interests differing from the interests of the corporation.

It rules that the Corporate Enterprises Law and the latest doctrinal arguments provide ample freedom to establish the remuneration system in the bylaws. It therefore states that although the precept in the bylaws could have been more specific, there is no doubt that a system of compensation is established, as it states that it comprises "a fixed amount of money", and also contains specific procedures for establishing such amount "by a General Meeting resolution each year". It thus allows the appeal and declares the rulings at first and second instance to be null and void.

Modifications of the remuneration system

Law 3/2014, 3rd December, amending the Corporate Enterprises Law for the improvement of corporate governance introduced important developments regarding directors' remuneration.

The Law provides that the remuneration system must be fair and in line with the economic situation of companies as well as the duties assigned to the directors. Such remuneration should strive to promote corporate profitability and sustainability in the long term.

It also states that the corporate bylaws will set forth a system remunerating directors for their management and decision-making duties. The General Meeting is competent to establish the

maximum amount of their annual remuneration, while the Board of Directors has powers to establish the remuneration of each director, thus ensuring that the General Meeting has the final say over such remuneration.

Moreover, the Law obliges listed companies to seek approval from the General Meeting for a remuneration policy that specifies the maximum amount of remuneration. This policy must be adopted and ratified every three years.

Annual corporate governance report for bank foundations

Banking foundations are a new figure in the Spanish legal system, created by Law 26/2013, 27th December, on savings banks and bank foundations. This provision required certain savings banks to assign their financial business to a Bank and manage their community service activities through bank foundations.

The initiative gives a comprehensive description of the content to be included in the annual corporate governance report of the bank foundations. It also establishes that the governing body of the savings banks, the Board of Trustees, will hold maximum responsibility for the preparation of the annual report and for its correct dissemination.

Structure of the annual corporate governance report

The corporate governance report must contain:

Information on the structure, composition and functioning of the governing bodies
Information about appointments policy, with special attention to remuneration policy, providing a comprehensive breakdown of the remuneration of senior staff: fixed and variable remuneration; per diem payments; compensation in kind; bonuses or premiums, and the criteria for their allocation; accrued benefits of services or activities other than those inherent to the position, etc.
Information on the Foundation's policy regarding investment in the savings bank, thus guaranteeing independence of powers between the two entities.
Information about related-party transactions and policy for managing conflicts of interest, with special attention to internal procedures to detect and resolve potential conflicts of interest that might affect the Foundation.
Information regarding the core activities of the Banking Foundation.

The bill includes an annex with the format of the report and instructions and definitions to facilitate and standardize its production.

The order has been drafted taking into account the latest recommendations from the code of corporate governance prepared by the CNMV and the requirements introduced by Law 31/2014, 3rd December, amending the Corporate Enterprises Act for the improvement of corporate governance.

The involvement of the CNMV means that the rules and obligations regarding content and dissemination of the annual corporate governance report for banking foundations are equivalent to those of listed companies and savings banks.

Commitment to enhance relations with users

The Peruvian Association of Banks (ASBANC) is making an effort to improve and consolidate relations with users of the financial system. It has drawn up this code of good practices for relations between financial institutions and users (hereinafter “the Code”) so that its member banks can self-regulate on the principles and guidelines contributing to enhance the relationship.

Principles and commitments

The Code identifies five principles: (i) Financial information, (ii) User information, (iii) Customer care, (iv) Security; and (v) Complaint handling. It establishes a set of commitments for the members of ASBANC that wish to have more lasting relations with their users.

These include: i) having financial education policies and/or procedures, which must be periodically reviewed, ii) training employees in financial education matters, iii) providing users with information on their products and services before, during and after the consumer decides to use them, iv) publicly disclosing transparent, true information that is understandable to users, v) continuously improving their customer care mechanisms and the touchpoints through which the user contacts the banks, vi) giving users access to recommendations on how to use the products and services safely and securely, vii) having mechanisms to foster an equilibrium between the sales targets and the relationship with users.

Self-assessment questionnaire

The Code establishes that companies publish the results of their self-assessment questionnaire in September each year. Starting in 2016, members may voluntarily post these to their websites and the ASBANC website. They may also employ other mechanisms to disseminate and publish the information.

The Code makes the CEO of each ASBANC member responsible for the appointment of an officer to draw up the self-assessment questionnaire to assure that it complies with these principles.

Review of the European Directive on shareholder rights

The draft reform of Directive 2007/36/EC of the European Parliament and the Council created with the main objective of promoting shareholder involvement in the management of listed companies, large corporations and groups of large corporations, and promote their long-term commitment to the company and its strategy.

Among other changes, the text added two new chapters to the Directive: Ia, Ib, governing the

identification of shareholders, providing information and facilitating the exercise of their rights; and regulating the transparency of institutional investors, asset managers and proxy advisors.

Effective and sustainable involvement

The document argues that an effective and sustainable involvement of shareholders in corporate governance helps improve the financial and non-financial performance of corporations. It thus deems it important not only to consider the proper exercise of shareholders' rights, but also to ensure that there is a culture of transparency and dialogue with and between all stakeholders, to improve the transmission of information within organizations.

It provides certain advantages for the shareholders of the company, to encourage more long-term participation and involvement: additional voting rights, tax incentives, and dividends and loyalty; if they are shareholders for more than two years.

On the other hand, it also argues that companies should be able to request identification of shareholders and communicate directly with them, establishing a framework for shareholders to be clearly identified. Information concerning their actions must always be provided on the organisations' websites.

To boost transparency, the regulatory provision requires that companies supply information on their operation regarding profits, taxes paid on benefits and subsidies received in order to ensure confidence and facilitate the involvement of shareholders and other stakeholders in society, considering all as an essential element of corporate social responsibility.

Engagement policy

The culture of transparency is applied equally to the companies' institutional investors and asset managers, which should publish their investment strategies and develop policies of engagement, to determine how they:

– Integrate the engagement of shareholders in their investment strategy,

– Supervise the entities in which they invest,

– Maintain a dialogue with these companies and their stakeholders, and

– Exercise their voting rights.

These policies should also include measures to manage real or potential conflicts of interest in the company. They should be published and sent to customers and institutional investors each year. Should they not apply or not communicate their engagement policy, they must explain why not, offering a clear and reasoned explanation.

Remuneration policy for directors

The new directive uses compensation as a key element to ensure that the interests of the companies are in line with those of their directors. This is why it places such emphasis on ensuring that the remuneration policy be clearly identified.

In order to allow the shareholders to decide on the remuneration policy, they are entitled to vote on it at least once every three years on the basis of a clear, understandable report with a comprehensive description and breakdown of the remuneration received by each director in the last year. Companies must ensure that the policy is in line with their longer term business strategy, objectives, values and

interests, and integrate measures to avoid conflicts of interest.

Also, to ensure adequate protection of the interests of companies, shareholders or the companies' board of directors or oversight bodies should approve transactions with related parties. They must publicly disclose such transactions when they are performed, at the latest, along with a report drafted by an independent third party, assessing whether the transaction was made at arm's-length pricing and is in line with corporate interests.

Next steps

The draft was approved last June, and now Member States are in talks to reach agreement on the final document.

Recovery and resolution of credit entities and investment servicers

The publication of this law regulates recovery and resolution procedures for financial institutions and companies providing investment services (known as ESIs) established in Spain. It also regulates the legal status of the Fund for the Orderly Restructuring of the Banking Sector (FROB) and the guidelines for its activities.

Essentially European dimension

This law brings together the principles reflected in the earlier Law 9/2012, 14th November, on restructuring and resolution of credit entities, which it partially repeals, introducing various new aspects from the transposition onto the Spanish lawbook of Community regulation (Directive 2014/59/EU and 2014/49/EU). These include the following:

It extends the scope of application of the law to investment firms, except those whose share capital is less tan EUR 730,000 or whose scope of operations is limited.
It reinforces the preventative stage of resolution, requiring all entities have a *resolution and recovery plan* (and not just non-feasible entities). This plan must:
Be prepared and approved by the preventative resolution authority (Bank of Spain/European Central Bank or CNMV), following a report from the FROB and the supervisory body responsible for its oversight;
Reflect the resolution actions to be applied should the entity cease to be feasible;
Not presuppose the existence of public financial support or the injection of emergency liquidity.
It incorporates a resolution procedure other than the traditional bankruptcy proceedings. The procedure is to be overseen by the FROB, which means that rather than going through the courts, the general government sector supervises it. This is intended to help companies stay in business and to minimise the impact of their non-feasibility on the economic system and the public coffers.
It increases the scope of the bail-in mechanism to all kinds of creditors (whereas the previous law limited it to subordinated creditors), configuring new ways to recapitalise the company which the FROB may implement: (i) repayment or (ii) conversion of capital instruments and (iii) internal recapitalisation. It also offers a new regime providing maximum protection to depositors in the entities that are moving into the resolution stage.
It creates the Domestic Resolution Fund: a body without legal personality that will pay the resolution

measures, which will be administered by the FROB and financed with contributions from the private sector.
It establishes the legal framework for the FROB: it determines its composition –incorporating a member of the CNMV because of the extension of its scope to apply to investment firms; it increases the number of seats on its Governing Board, and defines the role of its president as the highest level of representation, in charge of ordinary management and direction, with an unextendable term in office of five years.

Additional and final provisions

In the *additional provisions*, the law describes the regime applicable to deposits should the credit entity enter into bankruptcy proceedings. It also includes a modification of the legal regime for the Deposit Guarantee Fund, harmonising the way it works in Spain with the way it works Europe-wide.

Its *final provisions* adapt Spanish legislation, amending earlier laws on the securities market, on bankruptcy proceedings and on corporate enterprises.

Mitigating the impact on financial stability

In all cases, article 6.8 of the law states that the recovery plan must be considered a corporate governance procedure, for the purposes of article 29 of Law 10/2014, 26th June, on planning, supervision and insolvency".

The regulations in this law constitute a mechanism to mitigate the impact caused by the resolution of an entity to the country's financial stability, thereby reinforcing market confidence.

Applicability

The law came into force last June, although the rules on internal recapitalisation will become effective as of 1st January 2016.

Disclosure of information by listed companies

Last June, the Securities and Insurance Supervisor (SVS) in Chile issued Standards 385 and 386 to improve and expand the information to be published by publicly traded companies regarding their corporate governance. They incorporate best practices in corporate social responsibility and sustainable development.

Standard 385 repeals Standard 341, published in 2012, to ensure that the companies:

Implement policies of corporate social responsibility and sustainable development: promoting diversity in the composition of their boards of directors and in the appointment of key executives of the company; and disseminating information to shareholders and other stakeholders
Improve the quality of the information contained in the companies' evaluation of their own board, involving external parties in its preparation

Disclose their management policy regarding conflicts of interest and publish the amendments to the code of conduct for the board.
Promote adoption of principles, guidelines and national and international recommendations from, eg, the Committee of Sponsoring Organizations (COSO), Control Objectives for Information and Related Technology (COBIT) and ISO 31000 and 31004.

Meanwhile, Standard 386 amends General Regulation 30, recommending that companies:

Send a scanned copy of the annual report to the SVS and fill in the electronic form relating to information on corporate social responsibility and sustainable development.
Include information in the annual report concerning:
Diversity of gender, nationality, age and length of tenure of directors, senior managers and other executives reporting directly to the board, and in the organisation as a whole.
Remuneration and gender (providing a comparative breakdown of information on salary by type of position, duties performed and level of responsibility for females relative to males)

With the publication of these standards, the SVS is creating incentives to provide investors with sufficient information to take well-informed investment decisions. However, the legislation merely recommends practices that companies can voluntarily decide to adopt, in the light of their own specific features and peculiarities.

Thus, in line with the “comply or explain” principle of codes such as the Unified Good Governance Code for listed companies (Spain, CNMV), the board of each company must disclose a clear, precise summary, on the SVS website, of how each particular practice is implemented or why it has not been applied.

Statutory exemption of legal entities from criminal liability

On 1st July, Organic Law 1/2015, 30th March, came into force, amending Organic Law 10/1995, 23rd November, on the Criminal Code. One of the main reforms it includes affects the criminal liability of legal entities, introduced in Spain under Organic Law 5/2010, 22nd June.

The most significant changes are:

It considers the adoption of an effective crime prevention scheme, prior to the crime, to be grounds for exemption from criminal liability. Article 31bis details the minimum content of such a scheme, which must:
Identify the activities in which crimes can be committed.
Establish protocols for making and implementing decisions with respect to these crimes.
Establish management models with sufficient funding to prevent these crimes.
Impose reporting obligations to the Supervisors regarding possible risks and breaches.
Establish a disciplinary system to punish breaches of these measures.
Periodically check that the system is suitable for preventing these crimes.

If the prevention scheme only partially meets these minimums or if it is set up after the crime is committed, it will be taken into account as an extenuating circumstance that may reduce the penalties.

It establishes that the scheme should be implemented and monitored by an independent chief compliance officer, legally entrusted with the duty of monitoring the effectiveness of the company's internal controls. For small companies, it includes the possibility of oversight and control activities being conducted by the board.
It increases the number of persons that can trigger the criminal liability of legal entities. Thus, in addition to the company's de facto and official legal proxies and directors, referred to in the previous legislation, it also includes all persons authorized to make decisions on behalf of the legal entity or who hold powers of organisation and control within it.
In order hold legal entities criminally liable, the law requires that they gain a direct or indirect benefit from the actions of their directors.

Although this law does not elaborate on the characteristics, structure and content of prevention model, or determine how to configure the internal supervisory and control body, it is clear that Spanish companies wishing to claim exemption from criminal liability should define their scheme according to what is known as the "effective compliance program" under United States law.

The lack of definition means a wider focus can be given to promoting the values needed to deter unethical actions rather than focussing narrowly on the standards or guidelines of the schemes. Although the reform introduces a defence against charges of criminal liability it is not compulsory so companies are free to adopt its recommendations or not.

Moreover, such schemes have an appreciable advantage as they can become drivers for spreading the uptake of positive business ethics.

Avoid Environmental Risk: a great challenge for all

A new initiative in regulation

On 28 March this year, under Resolution SBS 1928/2015, the Regulations for the Management of Social and Environmental Risk (hereinafter the "Regulation") was adopted for application to companies in the Peruvian Financial System. This is the first regulatory initiative by the Peruvian State through which joint and several liability is assigned to financial entities for environmental damage caused by the projects they finance. This regulation seeks to achieve greater environmental and social protection in Peru.

Within this regulatory framework, the minimum requirements for managing social and environmental risk are established, promoting the implementation of best practices and prudent risk-taking by institutions in the Peruvian financial system. For example, they are required to evaluate social and environmental risk prior to granting any credit or finance. The limits for admissibility of risk must be based on three categories measuring the impact of social and environmental risk: high, medium or low.

Although its regulatory nature is new, as Lorenzo de la Puente Brunke points out, this is not a new concern in international circles, since practically all the large banks worldwide have signed up to the "Ecuador Principles", based on the "Performance Standards on Environmental and Social Sustainability" of the International Finance Corporation, a member of the World Bank Group.

Application Requirements

The Regulations will be applicable when offering advisory services, financing, bridging loans and corporate credit facilities in excess of USD 10m; and services to non-retail customers where the total amount of project-related loans in the financial system account for a minimum of USD 50m and the total amount of credit to projects the company is a minimum of USD 25m.

In such cases, says Lorenzo de la Puente Brunke, financial entities must require a document to describe the background to the current situation, due diligence procedures and evaluation of potential impacts, mitigation measures, engagement and dialogue levels, and grievance settlement mechanisms.

Disclosure of information

Financial companies issue a report to the supervisor and the general public at least once a year, assessing the social and environmental risks associated with all services they provide. And every quarter, they must file a report with the supervisor on each of the clients to whom they have provided services, stating the amount of funding, its category, and the economic sector and geographic location of projects and/or primary suppliers of projects.

That regulation will come into force on 1st February 2016.

Zones of Rural, Economic, and Social Interest (ZIDRES)

The Colombian Congress is studying the possibility of creating Zones of Interest for Rural, Economic and Social Development (ZIDRES, to use their Spanish acronym). In general, ZIDRES are:

Territories that can be used for farming.
Located within Colombia.
Isolated from the larger towns.
Have specific characteristics that impose high costs on making them productive.
Have low population density and high poverty indices.
Lack minimum infrastructure for transport and sale of produce.
Are not suitable for family production units to encourage productive projects benefiting landless agrarian workers and promoting capital investment in farming businesses.

On being declared ZIDRES, the territories will be considered of public utility and general interest, and the following goals will be pursued:

Promote the social inclusion of agrarian workers as productive social agents.
Increase sustainable productivity of the land.
Promote social and economic development in the zone.
Improve the quality of the land for farming.
Incentivise conservation of the environment.
Promote access and regularisation of the agrarian workers ownership rights to the land.
Promote rural employment and food safety.
Create special lines of credit and action plans to raise bank funding for productive projects for

enterprises and for capitalisation.

This last point is of special importance, since microfinance entities have is a sales network especially targeted at potential markets in territories where there is little access to traditional banks. The challenge for such entities, then, will be to design products for entrepreneurs wishing to do business in these newly declared zones of special interest in Colombia.

Excess liquidity in publicly owned entities

The Colombian government presented a draft decree for dealing with the excess liquidity in the general government sector, to establish rules for authorising local and national government entities to invest surplus cash flow from their budgets.

In principle, the decree will offer a growth opportunity to microfinance entities that meet its requirements. Traditionally, the investment rules for public entities were highly restrictive in Colombia. However, this new type of leverage is much more attractive for microfinance entities than other traditional mechanisms such as the issuance of To-Term Deposit Certificates or the opening of retail savings accounts, given the large amounts of money flowing through the Colombian government organisation.

General specifications

It defines excess liquidity as the positive difference left over after subtracting daily cash requirements and short-term obligations. It also establishes how this must be calculated.
It lists the acceptable investments with such excesses, including savings accounts and interest-bearing accounts and CDTs (To-Term Deposit Certificates) issued by financial institutions.
It allows the investments to be made in Colombian legal tender or foreign exchange.
It lays down rules for reciprocity agreements between publicly owned entities and banks, consisting of products and services packaged by the banks for the entities to deposit their funds.
It obliges financial institutions to ensure compliance with the investment rules in the decree.
It obliges the entities covered by the decree to implement due policies and procedures to make these investments.
It lists the investments that are not allowed, such as swaps, repos, borrowing of securities, etc.

Risk rating

The institutions wishing to attract the investments of government bodies must meet the following risk ratings:

For investments of one year or less: highest rating for short term (BRC 1+), and minimum second best rating for long term (AA).
For investments of over one year:Highest rating for short and long term (BRC 1+ and AAA)

Interest rates chargeable on commercial transactions

The Colombian government presented this bill to include limits on the interest rates that can be charged on commercial transactions not carried out by financial institutions.

Thus, it aims to include various types of credit within the list of lending categories already established by Colombian legislation within Decree 1074/ 2015 “Decreto Único Reglamentario del Sector Comercio, Industria y Turismo”. These are:

Microcredit: This is the financing of a specific business unit and is allowed to charge a higher return than is authorised for ordinary retail lending.
Ordinary retail lending: This is the default type of credit, with no specific purpose, subject to the general ceiling on interest rates determined by Colombian law (1.5 times the Current Bank Interest certified by the Colombian financial supervisor, Superintendencia Financiera de Colombia).
Low-volume consumer lending: This is a recently created kind of lending, for no specific purpose and with limits regarding the amount that can be lent. A higher interest rate can be charged than on ordinary retail lending.

Pros and contras

This bill gives greater control to the Industry & Commerce supervisor over retail lenders that may be granting credit with interest rates above those permitted by law. It is intended to increase protection for consumers. However, it may be problematic to apply, since the dynamics of these types of credit are more suited to the financial sector than to the trade and services sector. Moreover, financial institutions are already bound by the additional regulation to which the trade and services sector are not subject, such as provisions against their loanbook, credit risk administration, etc.

The higher rates may be attractive for the non-banking sector, leading merchants to take higher credit risk with their customers without having lending experience or expertise, diverting their focus from their principal economic activity.

Strengthening the Mexican financial system: the Ficrea Law

The Ficrea Law, as it has become known, is an amendment of the Mexican Law on Savings and Credit, 5th June 2001. It is intended to protect the Mexican financial system from frauds such as the “Ficrea scam”. Ficrea was a financial company (SOFIPO) supported and supervised by the National Banking & Securities Commission (CNBV) of Mexico, which managed to defraud over 6,000 Mexican savers in 2014.

The main purpose of the law is to set up a more efficient and more robust system to provide unsecured credit, strengthening the role of the supervisors and offering enhanced protection to users of the Mexican financial system.

It provides for the creation of a relief fund of MDP 1.6 billion from which 80% of Ficrea’s former

depositors can recover their savings, and another fund to pay MDP 1,000 to other creditors of the entity.

The SOFINCOs, as Mexico's rural microfinance institutions are currently called, now have until 31st July 2016 to apply to the CNBV authorized for licences to constitute and operate as SOFIPOs. Since SOFINCOs and SOFIPOs offer the same services to customers for all practical purposes, and the regulations governing the two are the same, it makes sense to unify their structures in order to facilitate their supervision and control by the CNBV.

Principal changes

Direct supervision of SOFIPOs now exclusively tasked to the CNBV, without involving intermediate bodies such as the Federaciones.
The maximum deposit that can be made in these entities by individual depositors is MDP 1m, while the ceiling for corporate depositors is MDP 5m.
The law encourages stronger corporate governance measures for these financial organizations:
At least 25% of seats on corporate boards must be for independent directors.
The requirements regarding the professional honour and suitability of directors are tougher. Directors will now have to demonstrate a satisfactory credit history and extensive experience in the financial sector.
Directors, managers or employees responsible for malpractices in the accounting and reporting of these companies are now liable for tougher fines and disciplinary proceedings.

Opposition and criticism

Although this reform is intended to strengthen the Mexican financial system, some aspects have incited criticism.

Representatives of the Sociedades Financieras Comunitarias and of the Sociedades Financieras Populares [Community Financial Companies and Popular Financial Companies] argue that the reform will limit the number of productive microloans granted to those who need them most. They fear that the law ignores the financial requirements of the most disadvantaged sectors of the population.

Corporate governance

The amendment of the 2001 People's Savings & Loans Law responds to the need for rules on good corporate governance for these financial companies, whose reputation has been tarnished by the Ficrea scandal.

This reform focuses on the importance of independent directors, establishes tougher eligibility requirements for members of the board of directors and provides for more intensive supervision of their activities by the CNBV.

Current legal status

The reform has been approved by the Chamber of Deputies, but is now awaiting its passage through the Senate, as it was not approved in the last session of the upper chamber, held on 30th April 2015.

Greater access to finance for small entrepreneurs

The Fondo Ganadero de Paraguay (FG) is a State-owned financial institution for technical assistance and development. Its main purpose is to provide financial and technical help to the country's livestock farmers.

Purpose

The bill authorises FG to issue bonds in order to reinvest the proceeds in loans exclusively for financing productive activities of micro, small and medium sized enterprises in the private livestock sector.

The redemption date for the bond issue is three years. Microcredit may be granted to micro livestock enterprises that may not be for more than 25 times the prevailing minimum wage (USD 10,400); for small and medium sized enterprises, it may not be more than 2% of the minimum capital for financial institutions (USD 67,000).

Access to the capital markets

This bill gives the FG the possibility of raising low-cost funding on the capital markets at rates below those offered by banks, so that this can be reinvested by placing loans under favourable conditions for microentrepreneurs.

Money laundering prevention

The main regulations brought in under this resolution, adopted by the banking watchdog of the Republic of Panama on 26th May, supplementing Law 23 for the Prevention of Money Laundering, the Financing of Terrorism and the Financing of Proliferation of Weapons of Mass Destruction, adopted by the National Assembly of Panama on 27th April 2015, were already analysed in the third issue of *Progreso*.

The resolution includes various provisions regarding the due diligence that must be carried out on customers before granting credit; the mandatory identification of the ultimate beneficiary of the transaction; and the identification of Politically Exposed Persons (a new concept in Panamanian law). It sets forth details about how these entities' compliance departments must work, and how the chief compliance officer must liaise with the *Unidad de Análisis Financiero*. Entities must maintain appropriate confidentiality and protection for employees who perform this task. Entities are obliged to keep their KYC Policy Manuals up to date at all times. Such manuals, by ensuring financial institutions know their customers and know the final beneficiary of transactions, are vital tools in managing regulatory compliance.

It will be a challenge for regulated financial and non- financial entities to adapt to the new legal framework. However, the legal certainty brought in by having controls based on industry-wide practices and consistent legal standards can only strengthen the financial system and the country's image.

New regulatory AML scheme

The banking supervisor, SBS, published Resolution 2660/2015 on 18th May, approving the regulation for management of money-laundering risk and terrorism-funding risk. It applies to companies in the financial system and private pension-fund managers (hereinafter “the Companies”).

The resolution is intended to establish anti Money Laundering and anti Financing of Terrorism (hereinafter “AML / AFT”) criteria to boost the effectiveness and efficiency of the AML/AFT system, reflecting international standards, industry-wide best practices, as well as specific issues identified in the course of oversight.

In addition to establishing new regulatory requirements and clarifying responsibilities, the regulation also provides for an Adequacy Plan, which the Companies must prepare within ninety days from the date on which it comes into force. The Adequacy Plan must be approved at board-of-directors level, then submitted to the banking, insurance and private pension fund supervisor (“SBS”). At a minimum, it must contain a preliminary diagnosis, scheduled actions, the officials responsible for it and a timeline.

The resolution states that the Companies must implement an AML /A FT system with components including regulatory compliance and management of ML/FT risks.

The final goal of the supervisor is to develop a new regulatory AML /AFT framework. It has placed several new obligations on companies, the most important being: i) an AML / AFT rating to score customers; ii) the issuance of a report assessing the level of ML / FT risk exposure, prior to launching new products or services and before entering into new geographic areas; and iii) the issuance of a ML / FT Risk Assessment report every two years and a review of the associated methodology every four years.

It also regulates a number of obligations intended to strengthen due diligence policies regarding directors, managers and employees, who must also receive training in an AML / AFT programme approved by the Company board of directors.

This resolution came into force from 1st July 2015, repealing the regulations approved under SBS Resolution 838-2008.

Legal framework for the regulation of investment banks

Under SBS Resolution 3544/2015, the Supervisor of Banking, Insurance and Private Pension Fund Administrators (“SBS”) approved the Regulation of Investment Banks (hereinafter, the Regulation).

It seeks to focus the supervision of investment banks more on their specific line of business. Thus, it ensures oversight of issues such as their corporate purpose, requirements on how they must be constituted and their operating licences, permitted transactions, and the prudential measures that

they must report to the supervisor, as well as other matters pertaining to investment banking in the country.

Adapting the existing regulation related to the requirements highlighted in this area, the Resolution amends the Chart of Accounts for Financial Institutions, the Internal and External Audit Guidelines and the SBS Disciplinary Regulation, so that investment banks are now subject to specific standards over and above those governing banking in general.

Access to housing for low income people

This decree establishes a special voluntary scheme for the development and renting of housing, with rules ensuring legal certainty for the parties involved. It aims to encourage investment in real estate and to reduce the shortfall in the supply of rental properties in Peru, while also improving the quality of the housing.

The decree creates mechanisms to facilitate access to housing for people in the low to middle income bracket, through (i) rental, (ii) rental-purchase, and (iii) leasing of buildings intended for housing. It will thus be essential for financial institutions to adapt their lending strategy to these mechanisms, in order to boost the real estate market and the Peruvian economy.

Anti-Money Laundering: a challenge for the European Union

The fourth European directive on the prevention of the use of the financial system for money laundering and terrorist financing was enacted on 20th May this year. The first directive (Directive 91/308/EEC) was adopted in 1991.

What is new in this Directive?

The principal change in European law with this Directive is that henceforth Member States must ensure that the entities incorporated within their jurisdiction provide adequate, accurate and current information on the identity of the real owners of their shares and securities.
Member States must keep this information in an independent, central registry. They are empowered to establish its characteristics and structure.
Oversight of suspicious transactions in financial institutions and banks is toughened. The institutions must identify and monitor:
All cash payments and receipts for entrepreneurs and professionals of over €10,000.
All transactions by any one individual customer of over €1,000.

The Directive indicates that special attention should be paid to customer identification procedures, with more rigorous identification and other requirements for people who hold or have held high public

office, or are in senior positions in international organizations.

Member States have until the 26th June 2017 to incorporate the Directive into their national law.

International cooperation

Money laundering and terrorist financing are crimes that are not usually committed in one country, but take place in an international context. That is why cooperation and coordination between the different members of the European Union is essential if the implementation of these rules is to be effective.

The Directive has been drafted taking into account the recommendations of the Financial Action Task Force (FATF), a worldwide benchmark in the fight against money laundering and terrorist financing, thus ensuring that the rules in the Directive are consistent with the national legislation of each country.

Solidarity Group

The objective of this regulation is to promote access to formal finance for disadvantaged populations traditionally under-served by the financial sector and allow a better analysis of their credit risk, thereby facilitating greater access to basic financial services.

In this context, the regulation defines and regulates one of the main forms of “group lending”, known as “Solidarity Group Credit”. Such loans are granted by an entity in the financial system to a group of people who are then jointly liable for the debt obligations acquired. Thus, the group as a whole is the borrower.

The regulation stipulates that the Solidarity Group must have not less than five (5) or more than thirty (30) members, who must know each other and voluntarily form the group. Their domicile must be in a single geographical area, where they conduct their activities, so that the group can be monitored. However, it allows for two types of solidarity groups according to their ability to manage the loan themselves. Thus, there can be solidarity groups that manage their own credit obligation and others that require external management.

The prudential rules for the proper management of the Solidarity Group loans for entities that grant such funding include:

Establishment of early warning signals to flag Solidarity Groups that are having problems repaying their loans;
Periodic reports on the Solidarity Groups with high credit risk, to monitor their repayment performance and their balances and disclose how they are managing the risks to which they are exposed;
Periodic retrospective analysis of all Solidarity Group loans, determining the causes of non-payment using sampling techniques.

New second chance mechanisms

This law, passed in July, introduces rules on debt relief, providing a mechanism by which borrowers acting in good faith but with outstanding payments could have a second chance under the country's bankruptcy regulations

Extension of the mechanism to individuals

For the first time under Spanish bankruptcy law, debt relief is extended to individuals. This has entailed setting up a more flexible, more effective system to give borrowers a second chance to repay their debts, which becomes applicable after completion of bankruptcy arrangements with creditors.

The law introduces a new alternative payment exemption for retail borrowers. After completing bankruptcy proceedings, borrowers unable to pay outstanding instalments and wishing to benefit from this mechanism must commit to a five-year repayment plan. During this period, no further interest will accrue.

The law extends the possibilities of reaching amicable agreements out of court, and accords the bankruptcy mediator a more important role. The mediator must be appointed by a notary public and after analysis of relevant documents may put a stay on foreclosure proceedings.

Purpose

The main purpose of the Law is to enable individual borrowers who have had problems with their business or personal economy to undertake new initiatives without being burdened for life with a debt they are unable to meet. It establishes tools designed to help such borrowers without prejudicing the interests of creditors and without encouraging borrowers who have acted in bad faith.

Spanish law is thus responding to the demands of international bodies such as the IMF or the OECD, which have demanded better, more effective regulation to mitigate the debt overhang affecting too many Spanish households in the aftermath of the crisis.

While many Spanish citizens are still reeling from the economic recession, this law could provide a much needed boost for entrepreneurs with a feasible business plan.

Rural Microfinance Fund

The Colombian government regulated the *Fondo de Microfinanzas Rurales* (Rural Microfinance Fund, hereinafter "the *Fondo"*), created by Law 1731/2014, as follows:

Defining the purpose of the *Fondo* as promoting access to financial products for small producers and micro, small and medium-sized enterprises (MSMEs) whose business is conducted in a rural environment.
Defining rural microfinance as financial services (eg, microcredit, microinsurance, microleasing, microfactoring, microcollateral and microsavings) granted through microfinance technology to small producers and MSMEs whose business is conducted in a rural environment.
Defining microfinance technology as the special methodology for risk assessment, placement,

management, control and monitoring of transactions, and the main source of access to financial services for the user profiles the Law describes.
Appointing the Fund for Agricultural Financing (Finagro) to manage the *Fondo*. (Finagro is a public entity specialising in rediscount lines for farmers.)
Indicating that the *Fondo* will receive an initial injection of capital from the national government through the Ministry of Agriculture & Rural Development, after which it must be self-funding, placing credit and rediscounting short-term debt.
Establishing rules for agricultural solidarity funds to be capitalised when market prices of agricultural products fall significantly, using strategies such as debt purchases from non-financial entities, land buyback, etc.

Activities eligible for funding

The decree provides for financing activities to help the rural population, promoting (i) access to financial instruments, such as collateral and value chain schemes, credit mechanisms, savings, investment, insurance and risk hedging; (ii) financial education; (iii) mobile technologies.

The law represents an opportunity for growing the portfolio of microfinance institutions operating in rural areas, freeing up mechanisms to enable them to lend to rural entrepreneurs under better conditions with the money they get from the Fondo. It also represents a major opportunity for microentrepreneurs to access finance for their businesses in rural areas of the country.

Responsible regulation for innovation in microfinance

Claudio González-Vega

In faithful reflection of its original aims, this fourth number of the online publication *Progreso* preserves its focus on (i) the evolution of the legal framework of regulation and supervision, with which diverse authorities constrain the undertakings of microfinance institutions, and (ii) the evolution of the structures of corporate governance, with which these organizations define their own course of action and the incentives that motivate the participants in their efforts. Jointly, the legal framework and the structures of governance are a determining factor in the performance of these organizations and in the achievement of the objectives mandated by their mission.

In its fight against financial exclusion, with the aim of promoting the inclusive and sustainable economic and social development of disadvantaged populations, the BBVA Microfinance Foundation has adopted its own approach of a responsible supply of financial services for productive activities. The achievement of this goal requires, however, the existence of an equivalently responsible regulatory framework. In this respect, however, recent years have witnessed, in Latin America, both major advances and relevant reversions. This publication attempts to report on trends that influence the evolution of this framework, to support better-informed decisions and facilitate the debate.

A view of microfinance from a perspective of legal systems will be critical in successfully addressing the challenges emerging both from the increasing maturity, complexity, and competition in the sector and from the risks resulting from varied, fast and unpredictable changes in the environment. In turn, a correct understanding of the true nature of microfinance should guide future regulatory interventions in this sector. What today we know as microfinance has been the outcome of a series of remarkable innovations in the production and the delivery of various types of financial services to populations that had not previously had access to institutional finance.

Actually, the essence of microfinance has neither been so much the very small size of the transactions nor the fact that the clients are poor. Rather, its essence has been the development and implementation of innovations in financial technologies (for lending and for deposit mobilization) that have made it possible to prudently manage the risks associated with the target clienteles, among the poor, and to lower the costs associated with very small transactions.

In these production functions for financial services, modern information and communication tools will increasingly be key inputs, but the critical components of microlending technologies have been: (i) the collection in the field, interpretation, and use-in-decisions of personalized information (both to design services that match diverse client demands and that lead to positive impacts in their lives and to determine the ability and willingness to repay of loan applicants) and (ii) the design and enforcement of contracts (in order to secure the sustainability of client relationships and create robust incentives to repay).

A critical dimension of success has been the signal that a loan is a contract and that, as in any contractual relationship, it creates rights and responsibilities for *both* parties. This notion of microcredit as a contract emerged in sharp contrast with the earlier notion of credit as policy tool, which easily became an electoral instrument. When viewed as a public policy tool, credit was a top-down intervention (not client-centric), with the authorities either granting a favour (transferring a subsidy) or mandating a behaviour (conditioning the use of the funds). This perspective destroyed the culture of repayment, an important dimension of a country´s social capital.

If, in contrast, a microloan is viewed as a contract, then the borrower commits to its repayment as agreed and, at the same time, she acquires rights, in terms of the suitable quality of the service, the transparency in the revelation of the actual terms of the obligation, and the expectation of improved conditions in future interactions with the institution. In turn, the institution acquires the right to receive repayment as promised, in order to protect its equity, but it also incurs the obligation of delivering services appropriate to the client´s conditions and of protecting its own sustainability, in order to be available when the client may require its services in the future. This is what responsible and sustainable finance is about. The interaction of these rights and obligations, of both the client and the institution, determines the quality of the relationship.

Claudio González Vega during a meeting in Bancamia (Colombia) in 2014

The core of the new lending technologies developed by microfinance institutions has been the creation, *in situ*, of credible relationships that are mutually valuable. Indeed, these relationships constitute explicit or implicit long-term contracts, which create structures of incentives that influence the behaviour of the parties in the contract. In turn, these structures of compatible incentives encourage investment, by both parties, in the continuation and deepening of the relationships.

Indeed, the present value of these future relationships, for either one of the parties, has been the element of the lending technologies that has nurtured the astounding repayment performance of microfinance borrowers and the exponential growth of these institutions.

These relationships have been more valuable when attractive productive opportunities have been available to the borrowers (which allows them to fulfil their repayment obligations without being impoverished and to benefit from a positive impact from the relationship), when the services delivered have matched the demands and financial strategies of the client households, and when the institution has been perceived as sustainable. The value of the relationships has lowered the costs and the risks faced by the microfinance institution which, in turn, has made the expanded breadth and depth of outreach of its services possible.

Similarly, the expansion of the dimension of deposit facilities of microfinance institutions has reflected key innovations in savings mobilization, with the development of new products (such as debit cards with biometric identification) and the broadening of delivery channels, both through the expansion of the branching network and the use of branchless mechanisms, that go beyond, such as networks of correspondents and the use of cellular phones and online banking, thus allowing a more accessible service, appropriate to the client´s circumstances. This progress has been facilitated by the development of more flexible prudential norms (such as the authorization of basic accounts, with simplified procedures), better-adapted to modern technologies. These norms have attempted to optimally combine, on the one hand, concerns for the safety of the depositor´s savings and the need to cultivate the public´s trust and, on the other hand, an acknowledgement of the unique challenges of expanding deposit services towards marginal areas and populations.

Thus, the strength of contractual relationships has been at the roots of the success and has constituted the essence of the innovations that have characterized the microfinance revolution. Therefore, as the regulation of financial systems will evolve in the future and as new efforts to create legal environments appropriate for microfinance will emerge, it will be critically important that a responsible regulation makes sure that these contractual relationships continue to be protected rather than being degraded. Given increasing political pressures on the authorities, this will be a formidable responsibility.

The task faced by a responsible regulator is not easy and, after the international financial crisis, the challenge has become even more complex. At the most basic level, the prudential regulator must achieve an optimal combination of at least two objectives: (i) to ensure the stability of the financial system, by promoting the trust of the public and by constraining the opportunistic behaviour of the various actors (in order to avoid the emergence of systemic crisis) and (ii) to promote both financial deepening (namely, the contributions of the financial system to increases in productivity and of the rate of growth of the economy) as well as financial inclusion (namely, the access and greater use of high quality financial services, at a reasonable cost, by broad sectors of the population. With increasing emphasis, in addition to these objectives, the protection of the consumers of all types of financial services, and not just of depositors, has become another goal of the authorities.

The reasonable achievement of these objectives is a complex task, which must avoid several types of mistakes. First, a basic obligation of a responsible regulator is to clearly define the rules of the game and to not arbitrarily modify them. When this is not the case, regulation no longer is an effective instrument to contain systemic risk and, instead, regulatory uncertainty becomes an additional source of risk for financial intermediaries and other market participants. Second, in any case, regulation and supervision are inevitably costly for all market participants. Beyond operational costs, both for the regulator and for the regulated and its clients, there are the opportunity costs that emerge from unnecessary restrictions on entry and unjustified prohibitions on the development of new products and procedures. These types of norms represent an important damper on innovation. Third, in the worst of cases, repressive regulation introduces distortions in the nature of the transactions and the role of the market, leading to serious inefficiencies and inequities.

In conclusion, the essence of microfinance has been the innovation in the delivery of financial services of small size, to poor clienteles. Its continued progress will depend on how the authorities face the need for innovation in their own regulation and supervision technologies, for a virtuous matching of the characteristics of the sector and the intervention of the authorities to emerge. Thus, the microfinance revolution must be accompanied by a responsible regulatory revolution, in which interventions are consistent with the true nature of the microfinance sector.

Santiago A. Cantón, Director of the Human Rights Program of RFK Human Rights

Santiago Cantón

Santiago A. Canton is the Director of the Human Rights Program of RFK Human Rights and was executive secretary of the InterAmerican Commission of Human Rights and the first Special Rapporteur for Freedom of Expression in the Americas.

Mr Canton was political advisor to President Carter for democratic development programs in Latin-American countries. He graduated in law from Buenos Aires University and has a masters in International Law from the American University's Washington College of Law.

How would you describe the performance of the Latin American economies and societies over the last 25 years? How has the performance of the economy and politics impacted society and human rights in the region?

It is too easy to make the mistake of generalising when you are asked about such an enormous region with such huge differences between the different countries. I hope that this will serve as an initial disclaimer, making it clear that not everything I say can be applicable in the same way to all the countries.

However, the region has enjoyed three decades or more of governments chosen by the votes of their people. This is an extraordinary feat for a region so accustomed to coups d'état.

In just over a century, we have gone through three waves of democracy in the region. The latest one began in the eighties, and has been the most comprehensive and the longest lasting. Although it has its difficulties, it seems unlikely that the tide can be turned back now. We cannot and we should not forget what an enormous achievement this has been.

Nonetheless, despite the progress, the rule of law is far from being what one would hope. Democracy in the ballot box has not consolidated any procedures to strengthen democratic institutions. It has not prevented overly strong presidential systems with strong personality cults from overshadowing and weakening them. Only when we manage to establish such procedures will our democracies stand on a sound footing.

In terms of economics, too, these decades have been very varied. There are enormous differences, for example, if we compare the eighties, the “lost decade” (which, as an aside, I might point out was the best decade, as it was when democracy was recovered) with the first decade of this century, when the economy grew thanks to rising commodity prices.

Yet despite enormous growth in the last ten years, the great majority of Latin-American countries are still highly dependent on international commodity price cycles. Until there is greater industrialisation, this dependency will continue. The sad thing is that it not only affects the economy, but also politics, and society as a whole.

For human rights, the return to democracy, almost by definition, was like coming out into the light after the darkness of the dictators and setting off down the long road towards increased protection of human rights. Along the way, the response from the different states is impossible to generalise. For example, in judging liability for human-rights violations committed under dictatorship, countries like Argentina have made enormous progress, but others, such as El Salvador or Brazil are dragging their feet.

Important progress has also been achieved in the respect and/or protection accorded to certain vulnerable groups; for example, in the right to land for indigenous peoples or equal marriage rights. In human rights the path ahead must always be longer than the path already trod. And true enough, beyond the formal rights of women, the discrimination against women continues to be the biggest challenge we face in the region. Latin America is the worst region in the world for gender-based murders of women, with over 50000 a year. In general terms, although the fight to equality has won formal rights for indigenous and Afro peoples and LGTBs, in practice they continue to suffer discrimination.

What is your reaction to the reports of greater socioeconomic inequality and a slowdown of the economy in Latin America? What were the driving factors behind this? And what consequences might it have?

Economic inequality is a grave problem that not only costs thousands of lives each day, but is also the most serious threat to world stability. There are no words to adequately describe the fact that the 80 richest people on the planet possess the same fortune as the 3.6 billion poorest. This is unsustainable, however many cultural or even bricks-and-mortar walls are built to hide reality.

Our region is the largest contributor to such extreme inequality. Despite the progress stemming from growth during the first decade of 2000, Latin America continues to be the most unequal region in the world, along with Africa. Regional leaders, mainly politicians and business persons, should realise that if democratic structural changes to our democracy are not brought in peaceably, they could be brought in with violence. The main threat to democracy in Latin America is the poverty originating from the enormous gap between the rich and the poor.

What actions do you think the international community should take so that this greater inequality does not jeopardise fundamental rights?

It is clear that the political and economic order that arose after the Second World War needs immediate reform. The United Nations system that dates back to 1945, even with the extraordinary successes it has clocked up over these decades, is not representative of the current world order.

The mainly bipolar world of that time has been replaced by a world in which there is a large number of new actors. Not just states with major weight in the world equilibrium, but also new, non-state actors with enormous quotas of power and the capacity to create and destroy.

The current world order is not prepared to resolve the current conflicts, including those of enormous inequality. We have been reporting on this for decades, but little or nothing has changed, and as the recent Oxfam report warned, the tendency continues towards even greater inequality.

I do not think it is necessary to dig down any further into the relationship between poverty and fundamental rights. Education, health, housing, food, water, etc, are just a few of the many rights that for millions of people are simply an aspiration that will never become reality.

You have sometimes said that the international organisations have lost the spirit that inspired the Universal Declaration of Human Rights in 1948. How do you think it could be recovered to drive a common platform for defending and protecting human rights?

True. The spirit of 1948, with the Universal Declaration and the explosion of declarations, conventions and standards of all types to defend and protect human rights, no longer exists. Our region was a pioneer in the defence of human rights. The American Declaration was made prior to the Universal Declaration. But the spirit of Bogota, where the OAS was created and the American Declaration approved, does not exist any longer either.

In my university classes, I speak of the four pillars underpinning any system for protecting human rights and how necessary it is for all of them to work properly. They are: states, regulations, international institutions set up to supervise compliance with the regulations, and civil society, as the main driving force.

It is clear that nowadays many states do not have the will to uphold these rights in practice, however much they may praise the wonders of human rights. Recently, the OAS culminated a process that the member states called the Strengthening of the InterAmerican System of Human Rights. However, after more than two years of discussion, the states did not come up with one single idea to really strengthen those rights. Quite the contrary. Their only aim was to hamper what the InterAmerican Commission on Human Rights was doing, so that it could not go on performing its duties with the independence that was its hallmark in the seventies.

The spirit of 1948 will be difficult to recover, especially under current conditions worldwide, with new security threats reviving the false dichotomy between security and human rights.

It is also necessary for many current leaders in Latin America to stop politicising human rights to score their own political points. Only when we manage to unite all the political, social and economic forces under the banner of human rights will we be closer to calling out the first letter of the word “victory”.

The Fundación has developed a methodology we call Responsible Productive Finance, to offer various financial services (loans, deposits, insurance, payments) through its member entities to support productive activities and projects among the most vulnerable sectors of society, and to offer advice and training. To what degree do you think this kind of microfinance outreach contributes to promoting

human rights?

Without a doubt, offering microfinance services focused on responsible development is a very important step throughout our region, to incorporate groups of people into the production system who would otherwise be unable to enter. In RFK we also support such initiatives: Muhammad Yunus, one of the pioneers in modern microfinance, is one of the winners of our human rights prize.

It is fundamental that the support be focussed fundamentally on the most vulnerable groups in our region, who have historically suffered from structural discrimination, such as women, and above all women of indigenous and African descent.

The Fundación also actively tries to encourage the establishment of formal, transparent regulatory frameworks for the entities to work in this sector. We altruistically offer courses on corporate governance in Latin America for organisations within our group and outside it. What influence do you think the implementation of best corporate governance practices in the public and private sector has for the socioeconomic development of a country?

One of the main problems, with a direct impact on human rights, is the high level of corruption in the public and the private sectors of our countries. Having efficient control mechanism to ensure transparent management of public goods is another major challenge for us. Nowadays, several governments in Latin America are caught up in cases of serious corruption.

Do you see any progress in the public policies of the Latin-American states regarding the age-old inequality between men and women? Do you think there are still more violations against the human rights of women?

It is the principal violation of human rights we see in the region. Today an average of 15 women will be murdered in Latin America simply because they are women.

As I said before, we have the highest femicide index in the world, and also the greatest impunity. In a case in which the International Court of Human Rights found against Mexico, known as the “Campo Algodonero” case, the ruling mentioned the need to implement state-wide public policies to bring about social change.

What message was the court putting out to the region? That if we do not bring about profound changes in our society, we will be unable to stop structural discrimination and gender violence, which affect hundreds of millions of women in the region. Sadly, these changes are just not happening.

What memory do you have from each stage of your career?

Infinite memories… impossible to deal with all of them! If I had to sum them up, I would mainly say that I got to know extraordinary people who devote their lives to the search for truth and justice.

The force of thousands of relations of victims of human rights violations, especially mothers, that do not rest for a second and have absolutely no fear of anything, striving to find out the truth about what happened to their children, their loved ones. It is an indescribable force, a truly worthy cause that obliges us to rethink our priorities, values and goals in life.

Another aspect was being able to travel throughout all the countries in Latin America. I got to know our diverse cultures, histories, artistic outpourings, the challenges our peoples face, and that is

something that I carry within me forever. These things have been enormously enriching for me.

What was your most difficult professional challenge?

In general terms, sadly I have to say that it was getting any results in human rights. It is not easy. A Manichean way of using nationalism and sovereignty has resurfaced in the governments of the region, which is merely a way of dressing things up to gain electoral credits and at the same time avoid any oversight of their human-rights records. For example, Mexico has recently criticised the UN Special Rapporteur on Torture, simply for denouncing the grave situation in Mexico, and has withdrawn any future invitation. Argentina, Ecuador and Brazil, amongst others, have also taken stances that undermine the capacity to supervise human rights compliance.

On a more individual level, my main challenge was to maintain the independence of the InterAmerican Commission of Human Rights against the boundless efforts of the governments and even the General Secretariat of the OAS to influence its decisions. It was a round-the-clock job, 365 days a year. But I left with the conviction that I had managed to do it.

Given your long professional experience, you must have many a tale to tell. Would you like to share any with our readers?

Indeed. Many and of all kinds… happy, sad and moving.

Being surprised by people throwing their arms around me, people who had been unjustly imprisoned, whom we had helped achieve freedom, and whom I had never met personally before. Those embraces are unforgettable.

Being declared a Persona Non Grata in the Dominican Republic for denouncing serious electoral fraud and being abruptly escorted by military officers to the airport to expel me from the country.

All the statements made by the mothers of victims of human-rights violations before the InterAmerican Court of Human Rights, recounting the tragedies they had lived through, and seeing what enormous humility they showed as they simply requested truth and justice.

The shaming of governments defending the indefensible instead of complying with their obligations to make the region fairer and less violent. Luckily, I still get indignant that anyone can defend cases of tortures, rape, executions, disappearances and suchlike.

And finally, a lovely story, also from the Dominican Republic: I was walking around the old part of Santo Domingo with the former President, Jimmy Carter. A Uruguayan citizen (and I am sorry not to remember his name) tried to break through the security detail to give something to President Carter. When I saw that he couldn’t get through, I went up to him and, overcome by emotion, he gave me his card with his name on it and said please would I say thank-you Carter, because it was thanks to him that he was still alive. He said it was his government’s pressure on the dictatorships that enabled him to be set free.

Minutes later, when I told him the story, President Carter, who was also visibly moved, answered: “Saving human lives it exactly what we wanted to do and nobody would believe us.” I think that sums up in a nutshell what it means to work in human rights and this link between victims and activists.

What do you like to do in your free time?

Apart from being with my family, reading history, classical literature, writing, listening to music and spending time with friends, over the last few years I have also started riding a motorbike.

How would you sum up the history of human rights in the region?

Your question brings to mind an historic event, which was in a way a foretaste of things to come in human rights and Latin America.

In 1794, after the French Revolution, the Colombian hero, Antonio Nariño, obtained a copy of the French Declaration of the Rights of Man and of Citizens and decided to translate it into Spanish so that it could be known throughout all corners of the continent.

The new revolutionary ideas seeking for equality among all people were obviously not pleasing to the Colony. The copies of the translation were immediately burned and Nariño was condemned to 10 years of prison in Africa. When he got out, he managed to become Vice President of Colombia and one of the great heroes of independence from Spain.

In the fight for human rights, Latin America continues to lurch between progress and equality on the one hand and retrograde views of the world unmoved by the enormous injustice and inequality that is killing thousands of people each day.

We provide a global perspective of the most relevant regulations on microfinance and corporate governance

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Claudio González Vega

Costa-Rican economist and lawyer, with a Masters from London School of Economics and a PhD from Stanford University. Professor Emeritus and Director of the Rural Finance Program at Ohio State University. Trustee of the BBVA Microfinance Foundation. Consultant for international agencies and for financial authorities and governments in several countries. Lecturer at the Boulder Institute Microfinance Training Programme and at the Universidad Autónoma de Madrid Microfinance Masters Course. Over three decades' experience researching microfinance, he has authored numerous books and papers on economic development, poverty, international trade, rural finance and microfinance.

1. You became interested in rural finance from a young age. Was this for personal reasons?

It had to do with my upbringing. I lived in Costa Rica at a time when banking was run by the State. In 1948, the Costa Rican banks were nationalised, on the grounds that this was necessary to encourage more democratic lending. So, throughout my youth, I had to put up with all the inconvenience of inefficient, bureaucratic banks.

While still a university student in Costa Rica, I wrote a paper where I identified the enormous concentration of the system's credit portfolio. At that time, just 10% of the borrowers from the supposedly democratizing State-owned banks held 85% of the country's outstanding credit. I was amazed by the contradiction between intentions and reality. There might have been a political will to democratize access to loans, but lending was enormously concentrated in surprisingly few hands. My undergrad paper measured borrowing in the country and found it was more concentrated than land ownership or the income distribution. And I learned my first key lesson, which laid the foundations of my professional career: Good intentions are not enough.

The concentration was especially marked in agricultural borrowing, while I had been interested in the issue of poverty from very young, especially in the rural areas, where poverty tends to concentrate. Of all the portfolios, it was lending to farmers that showed the highest concentration. That was when my interest in the impact of policies on rural finance was born.

2. How is rural microfinance different from other kinds? What are the main problems? What do you think of farmers insurance?

There are two dimensions to this. There is a territorial dimension. Rural living means long distances from urban centres where people are concentrated and there is sufficient market size. It means low population density and high population dispersion. But there is also a sectorial dimension. Farming and activities related to the use of natural resources in general are enormously important in rural life.

These two characteristics set up barriers. First, distance is a tremendous barrier, pushing up transaction costs and making it hard to reach your customers. It is hard to get to know them and it becomes difficult to separate them according to their risk profile and demands. Distance pushes up the cost of monitoring, makes it expensive to visit the clients and to check out the results of their projects.

Second, rural populations are more heterogeneous than other populations. One plastics factory is very much like any other. One farmer and another, even at two-hundred meters distance, are tremendously different… You just have to go round the curve in the road and things change. The farmer on the other side of the hill cannot grow flowers because the sun does not hit his land in the same direction. So information, which is a key determinant of financial transactions, becomes a more

significant problem in the case of rural finance.

Third, being dependent on agriculture means that farmers depend a lot on things beyond their control: weather, nature, plagues, natural disasters… And these events tend to be systemic. They affect all the farmers in the same area at the same time, creating high covariance. This is the biggest problem for a financial institution wanting to work in rural areas. If something goes wrong, it is going to go wrong for all your customers at the same time. You can't diversify.

So you have to find a tool to tackle this systemic risk. The only tool we have discovered so far has been insurance against catastrophic events. But developing such financial tools is an area still very much in its infancy. Little experimentation has been undertaken to learn what might be done. Once this type of insurance exists, rural finance will have made real progress.

3. What do you consider to be the causes behind inequality increasing, even as GDP rises in Latin-American countries?

This is a tremendously complex issue, which possibly varies from one country to the next. But I can imagine two key determining factors, among many:

– The declining quality in education, as it lags behind advances in technology and the information economy, while more complex processes of value generation require human capital with high-level specialisation. The holders of this human capital (engineers, system designers, software and robotics producers, etc.) can use it to earn high incomes. However, less qualified workers, with less such human capital, are held back by the shortcomings in education systems that have not kept up with the times and do not enable them to improve their productivity or their wages. So the incomes of the highly educated continue to go up while the low-skilled workers, without much education, are stuck where they were. And the gap widens, even among people who depend solely on their work to generate income.

– At the same time, in some countries there are high legal, regulatory and bureaucratic barriers to moving from the informal economy to the formal economy. This is an issue that could be of great interest for your journal. How much does it cost to get a licence to operate? How much does it cost to get through the red tape? What are the asymmetries between being regulated or unregulated, in the formal or the informal economy, when you factor in taxes, requirements and other charges? All this leaves a lot of people trapped in the low-productivity informal economy. And these barriers prevent small family businesses becoming small firms that might employ say ten to fifteen workers, simply because it would require them to jump through so many hoops that doing so becomes horrendously expensive. It stops them before they start.

4. How do you see the medium-term future of the industry? What role will commercial banks and microfinance institutions play? Do you think the growth of this sector will slow down?

It is now fashionable to talk about financial inclusion. I think we should recognise various things here:

First, microfinance is an innovation for producing specific types of financial services, essentially for self-employed workers, family firms, small businesses, etc. It is one way of achieving financial inclusion, but not the only way.

A second observation is about a major paradox. On the one hand, mainly in a large metropolis such as Lima, Bogota or Quito, financial inclusion is substantial and even certain segments of population are over-indebted. On the other hand, in the same countries there are regions where the population is essentially excluded. This coexistence is a very typical phenomenon in developing countries. You have over-borrowing for some and a total absence of institutional access to borrowing for others.

The future is to be found by resolving this paradox. This will entail discovering institutional, regulatory

and technological mechanisms to reduce the incidence of over-indebtedness. And, at the same time, there must be a new wave of innovations, to enable us to reach out to where there is no institutional supply of financial services at all yet. Where there is nothing, there will be enormous opportunities for growth.

Perhaps the saddest thing is when the job is botched, when the credit decision is low quality and people are given more credit than they can afford. All they get is an ephemeral, transitory and fragile inclusion. Then, when it ends, they fall into a black hole, even harder to get out from than where they were to start with. They are penalized in credit bureaus, lose their reputation and are unlikely to be granted any further loans.

Who could do what is needed? A diverse range of entities; there is room for different kinds of players: banks, non-bank microfinance institutions, even some NGOs highly specialized in certain segments of the population. Each of them could operate alongside the rest, because they would have competitive advantages operating in some market segments and not in others, and vice versa.

However, we could imagine that commercial banking will continue to have a corporate emphasis, and it will take advantage of new information and communication technologies to develop transactional services, above all payments systems, money transfers, public utility payments, etc. The people who are currently customers of microfinance entities will also have access to these services. Nonetheless, at the end of the day, the banks that are newly trying to enter the microfinance sector with credit services are going to lose the game against the entities that started up doing microfinance, which will have already developed strong relationships with their customers.

Because history matters. Arriving ten years earlier means ten more years of learning, ten more years of getting to know your customers and developing loyalties. You can't reproduce that from one day to the next. Moreover, the banks' corporate culture doesn't allow them to have the patience to enter into this segment for ten years just to see if it might work out. Either they get an immediate payback when they try it or else, as soon as they don't do so well, they will leave. So I think that for the segment we are talking about (household-businesses, small self-owned firms, production-oriented microenterprises, etc.), the entities that have a microfinance focus and a microfinance technology, those that have cultivated direct relationships with their clients, are the ones that will survive in this segment of the market.

We are clearly entering a new stage in microfinance. There has been a structural discontinuity in what we could call the natural rate of growth in this sector. The first stage was about filling the void, at a time when one could grow very fast. But in any area of life (in physics, biology, markets, etc.) never-ending exponential growth is impossible. In the places where they have been operating (the others are still empty), these entities face a new era of slower growth, which we hope will be more prudent. For the larger entities, with a larger scope of operation, growth opportunities will be in new regions, new kinds of customers, new kinds of products, in a greater range of circumstances, rather than in doing more of the same in the same places that are already saturated.

5. Do you think that microfinance institutions should gain scale through consolidation? If so, where especially?

Scale matters a lot, because scale is the source of all kinds of economies. It enables you to dilute overheads, diversify and attempt different kinds of outreach, because you can operate in different locations and avoid the vulnerability of working in places of limited scope. Very local entities are tremendously vulnerable when something goes wrong. Say they are coffee producers in Oaxaca and there is a natural disaster or maybe international coffee prices fall. A cooperative there which only has coffee producers on its books cannot survive.

So, volume of transactions matters, to generate economies of scale. And geographic outreach matters, to reduce covariance. And portfolio size matters, to diversify over different sectors and

diversify across the size of your customers. Scale allows you to bring down costs and reduce risks; and that is good for everyone. Because if having some medium-sized customers in the portfolio enables you to dilute overhead and other fixed costs better, then interest rates can be lower not just for the medium-sized but also for the small customers. Yet, you couldn't have brought down interest rates if your only customers were small customers.

How do you get scale? There are many ways. It could be through mergers. I am slightly fearful about that. Putting two poorly performing small entities together to make a larger one does not necessarily make for a good entity. So mergers for the sake of mergers cannot be a panacea. But it is possible for an entity with sufficient capacity and clout to transform entities whose weaknesses have more to do with their size and limited capacity to raise debt, so what they are lacking is capital. There, in a takeover, merger or suchlike tone may take advantage of assets such as the local knowledge or the social and human capital that the weaker entity might have. Because, although it is possible that a given entity might enter into the business on its own, simply because it is bigger and has sufficient capitalisation to do so, in practice local human capital and knowledge are difficult assets to reproduce immediately. So you can go down different routes. It depends on the country, on the entities and on the market structure.

There are two issues that we should perhaps mention. What is this market consolidation going to be like? Well, that depends on the regulatory framework: the rules for getting a license to operate or for exiting, the requirements the entities must comply with. What should really happen is that the prudential regulator says, "Here is the market structure I want to have within five years or ten years." First you have to visualise what you want. "I want to have a financial system with robust, low-cost entities that offer access to different customer profiles, etc." Then you must ask "What regulatory framework must I adopt to reach this ideal structure I am proposing?" It is not a matter of creating ad hoc rules and putting out fires. The regulator must have a long-term view.

One of the things that the Peruvian regulator mentioned in Iquitos and I mentioned in my talk in Madrid is that "entities are lacking a long-term vision." But the regulator must also have a long-term vision. Indeed, it must have a longer-term vision, given that the regulator has to understand how the whole system needs to evolve over time. I think that in this long-term vision, it is more useful to society if a structure is developed with a reasonably small number of robust entities than with a multitude of fragile, perishable ones. The "reasonably small number" does not worry me in terms of competition, because I have learnt, above all in the financial market, that competition is more ferocious when it is between four or five giants than when it is between two-hundred midgets. What you need is a competition-friendly environment.

6. You know the Bolivian microfinance system very well. What are its specific traits?

Bolivia is the clearest example of how microfinance can become a substantial component in the financial system and a driving force of financial development in a low-income country with incomplete institutions. Too often we think of microfinance just as a tool for alleviating poverty or some such thing. But Bolivia is an example of how microfinance can also be important for the financial development of a country, for the evolution of the entire financial system.

Nowadays the loan portfolio of the microfinance institutions is substantially more than one third of total lending in the entire Bolivian financial system. Three quarters, nearly four fifths of the customers of any type of institution (banks, mutuals, cooperatives, etc) are customers of a microfinance institution. The microfinance institutions are close to accounting for 20% of the total Bolivian Domestic Product. These data show how much microfinance matters as finance, and how important it can be in the evolution of the financial system.

This was reached by a felicitous convergence of three sets of circumstances:

– A tremendously innovative environment with market freedom and a great diversity of entities

(individual credit, solidarity group loans, village banking) with different orientations but an enormous emphasis on innovation, where the quality of the customer relationship is at a premium as the central focus of innovation.

– A particularly well-suited specialized regulatory environment, which emerged from a continuing conversation and a dialectic process between the regulator and the market operators where, for example, Bancosol proposed doing something different, and the regulator said, "OK, let's see what happens." That way, the regulator learned and then formalised the new way of doing things, and thus the conversation unfolded. While reality was one step ahead, it was followed closely by the regulator, refining procedures and interacting with the players in the market.

– A non-opportunistic governance structure where, unlike banks and State-run financial institutions, the microfinance entities did not expect the government to do them any favours. They had no expectations of being bailed out if things went bad. And as there was no possibility of a bail-out, they were responsible, prudent. They took care and did not behave opportunistically (like the banks did, leading to the world-wide crisis). They did not expect anything from the government, and the government did not get involved either (not until last year). So there has been a process in which the microfinance institutions blossomed into the dominant sector of the financial system, thanks to the State refraining from imposing guidelines of one kind or another, capping interest rates or requiring portfolio quotas, and thanks to an environment of ultra-low inflation and reasonable economic growth.

Perhaps I should add something else. Why is Bolivia different from other microfinance experiments? Because, right from the outset, Bolivia was an enormous laboratory. There was nobody saying "Microfinance can only be done Grameen style or else it's not microfinance." No. There were credit institutions lending to individuals, there were group-credit institutions with joint liability contracts, village-banking institutions… All of them, right from the start, were trying to find solutions from their very different perspectives and with connections to very diverse international groups.

Bolivia was the arena on which the battle to discover best practices was fought. So, Accion International (the godmother to Bancosol) said, "No, what really works is solidarity groups." And IPC from Germany, with Andes Procredit, said, "No, what you have to do is individual loans". And Pro Mujer said, "No, let's do village banking." And, there in Bolivia, all these visions went into battle to see which one could outsmart the others. And, in this process, they made an all-out effort to do things well, but also learned from their peers. There were tremendous externalities, collective learning. Employees from one institution went to work at another. Know-how was spread around and mixed between them and a kind of cross-fertilisation took place that was enormously beneficial. In the end, the best versions of each model developed in Bolivia, with individual lenders, such as FIE, and village-banking lenders, such as CRECER, both of which have won several international awards for being the best in their class.

7. What are the main points that microfinance legislation should cover for sustainable development of the sector?

The regulator must understand that microfinance is different. But the difference that matters from the regulatory viewpoint is not that of good intentions. It is not that a different regulation is needed because the customers are poor or because they are women. Rather, it needs a different kind of regulation because the risk profile is different and because the credit methodology used to analyse this risk profile is different from the one that traditional banking applies. It the regulator does not realise that it is different, and tries to apply the same rules to both traditional banking and microfinance, as if they were the same thing, this will never be efficient. So that's where it has to start.

Second, the regulator needs to recognise that the costs of reaching the previously unbanked population are higher and behave differently from the costs of commercial banking. Consequently, it

should not interfere in price-formation policies, because these must reflect the cost differences and make sure the institutions are sustainable. And also, when distinguishing between risks, the regulator must clearly understand that consumer loans for wage-earners have a completely different risk profile from credit for self-employed customers working in a productive activity rather than drawing a wage. It you treat consumer lending the same way as microfinance, you kill microfinance.

There is definitely a lot of debate right now about the need to protect customers. It is obvious that if microfinance is a more customer-oriented business, on the grounds of minimal respect, there must be transparency and fair play towards the customers.

8. What role do you think multilateral entities and social-responsibility funds should play?

A negative role and a positive role… or what we could call a do-nothing role. Perhaps what is most important is to ensure an even playing field. Allowing a donor or an organisation to come along and give a million dollars to an NGO and say "Here's your million dollars to give credit at 2% interest rates, and if people can't pay, it doesn't matter if you don't recover the loan and everything else", and then allowing the NGO to survive and expand in a market where it is going to destroy the culture of repayment, where it is going to distort notions of contract, alter price structures, etc. well, that is destroying the even playing field. That kind of intervention is harmful to the ones that are doing things properly, who are really working well. It creates unfair competition, which is tremendously damaging to the sector. Many donors, many governments have these outdated notions, this kind of paternalism that makes them fund entities that are not going to survive.

Part of the consolidation process we were talking about before has to do with the need for an exit mechanism, so that entities that aren't doing their job properly and are doing damage can disappear.

On the positive side, there are two things the donors and funding agencies can do. One is to contribute to the creation of public goods and, very fundamentally, to the formation of human capital for the sector: grants, courses, internships, exchanges, etc. And contribute to the development of new technology, promoting pilot projects, the design of new products in their experimental stages and suchlike, to promote technological change in the sector. In the case of the investment funds, their role is to complement the entity's resources with funding in a responsible manner. And that means not just putting up money, but really taking responsibility for the entity's decisions and performance; behaving like a real owner. You can't just let someone put money into the fund for reasons of social responsibility or whatever, and then not oversee the entity or contribute to its management. You have to bring in know-how, new ways of seeing things, other ideas, professional management, along with the funds.

9. How important is corporate governance for the sector's transparency and restructuring?

An entity's performance, how much outreach they have, who they service, the quality of their services, how efficient they are, will very much depend on the decisions taken by all the stakeholders: credit officers, branch managers, regional directors, the risk unit, etc. And these decisions are not taken in a vacuum. Rather, they will be a response to the incentives structure, which says what consequences there will be for me, for the others, for our mission, if I behave in one way or another.

The key role of corporate governance is to appropriately and clearly define the incentives, reward structure. Some rewards will be monetary and others not, such as the possibility to grow professionally, job stability, being given tasks that you find stimulating, and suchlike. A structure where doing things well is rewarded and doing things badly is punished one way or another. But what is to be done must be clearly understood. Designing this kind of incentives structure is not a trivial endeavour, because you need insight into what drives people, what motivates them to do things well.

10. As a trustee in our Foundation, and someone who knows the microfinance institutions making up our group, what do you think is the hallmark Grupo Microfinanzas BBVA? What makes us different

from the rest of the microfinance institutions or groups currently operating in this world?

I think two inputs into the process make us different and, as a consequence, the results we get. One is the quality of the Foundation staff, both in the Madrid Foundation and in each of the entities. I go to the Dominican Republic; I go to Colombia; I go to Peru; I go to Chile… and wherever I go I am amazed at how special the people there are. They have a real integrity, real quality as human beings. I am not only impressed by their professional skills and abilities, but by their commitment, their charisma. You really feel that charisma throughout the Foundation.

The second difference is having found a formula to combine local knowledge, experience and reputation in one particular field with things that are harder to acquire without scale: systems, control mechanisms, tools, etc, coming from the expertise in the headquarters. Despite all the tremendous difficulties involved, the Foundation has managed to bring together both these facets.

The consequence of this has been rapid expansion, prestigious award-winning operations and being able to offer customers quality service with an eye to the future, a notion that coming into a relationship with our entities is not a one-off exercise but something that looks ahead to the longer term. It is a bit giving our customers a sound view of their future with the Foundation institutions. Other entities have this to different degrees, but all in all, with our operation in Latin America, this is the group that has it the most at present.

11. You have published masses of papers, reports and books. What would you like to write now?

There is a subject that is definitely applicable to finance, but applies to economic policy in general and even to people's lives, and that is the importance of history. And how, although it is important, we find it so hard to learn from it, and so repeatedly commit the same mistakes.

Latin-American governments had capped interest rates, imposed portfolios quotas, engaged in inflationary policies and other forms of financial repression, at least until the end of the Seventies. The consequences were disastrous and reform was inevitable. The stranglehold was loosened, allowing the market to breathe. But now, three decades later, the world has forgotten the lessons it had learnt and is trying to do the same as it used to do, using repression again. Why do they never learn? Especially the policy makers, why can't they learn the lessons of history? I would like to illustrate this with some examples from finance and microfinance.

12. What is the most pleasant moment in your day?

The sunset. There are two dimensions to this. I love dusk, when a palette of colours is combined with a feeling of peace and serenity. It is a moment each day when one says, "How marvellous, another day gone by in which I have done things, embraced someone, stretched out my hand…"

13. Tell us something that you really like, apart from research and writing.

I like a whole bunch of things, but there are two things I am especially passionate about. I love Nature, and when I have the time and the opportunity I go out hiking in the mountains or along the beach, just to walk and observe Nature. But I am also passionate about art. I love all kinds of music, visiting museums, and am a movie-addict.

14. Do you get on well with lawyers? Any stories you could tell us?

I have a surprise for you: I am a lawyer! My grandfather and my father were lawyers before me. Even as a child, my father used to sit me down next to him and discuss his cases, telling me about the litigation he had underway, the contracts he had drawn up… From very young, I helped him with documents, you know, like writing up deeds in a protocol or whatever.

I studied law and when I graduated, I got a British Council scholarship to go to London to do my Master's degree. After that I never went back to practice law professionally. But my legal training has been enormously useful for learning how to debate, how to organise arguments, how to think about things within a logical structure… So I am very happy to be a non-practicing lawyer with a legal training.

15. If you hadn't been a teacher, researcher and writer, what would you have liked to be?

I would have liked to be everything, but if I had to choose just one: then an architect. I would have liked to be an architect who would have been especially skilled in finding equilibria between what comes from Nature and what is human, able to design spaces where Nature and our humanity could meet in harmony.

16. A final confession: tell us something you have not yet done and would like to do.

Write a novel that had nothing to do with economics. A novel on the multiplicity and complexity of human relations; a novel in which the characters have more than one relationship and all of them are highly complex.

17. What character from history would you like to have known?

I could think of three, for different reasons and at different levels:

– Jesus. Regardless of his divinity, because he was the human being who most transformed the way human beings see others.

– Leonardo da Vinci. Because of his tremendous imagination, his capacity to imagine multiple worlds.

– Nelson Mandela. He is a recent, contemporary example of the power of forgiveness

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Proposal for European Data Protection Regulation

On 12th March 2014, the European Parliament adopted the text proposed by the LIBE Committee Civil Liberties, Justice & Home Affairs) giving the go-ahead to the reform of the European Data Protection Framework. All it requires now is approval from the Council for the new regulation to replace the prevailing directive 95/46 (dating back to 1995).

The draft includes the Regulations as such, plus a directive of minimums, which will be applicable to personal data processed in the framework of police and judicial cooperation.

The reform is aimed at modernising European legislation on data protection in response to the latest communication and technology systems, establishing new control mechanisms and grievance procedures for data processing, as well as the standardisation of the currently inconsistent patchwork of laws in different member states.

The proposals have been highly controversial, eliciting criticism from different sectors, but especially from business associations, due to the proliferation of regulations the reform would introduce, which

could overload companies with checks and controls, and expose them to the risk of extremely tough fines.

The main changes contained in the proposal include:

Apointment of Data Protection Officers throughout Europe
Privacy by design and privacy by default requirements for products and services. (The aim here is to protect product users' privacy with a set of measures to provide greater control to stakeholders on the dissemination of their own data and the way it is processed)
Privacy impact assessments. (Data controllers and processers are obliged to assess the impact of data protection)
Principal of accountability. (The company assumes overall liability for any data process, whether done in-house or outsourced to a third party).
Obligation to report incidents. (Notification must be submitted to the Control Authority and the parties affected by the incident).
Audits and controls on compliance.
Fines: up to €100m or 5% of global annual turnover. (Discretionary fines disappear).

European Data Protection Seal. (This is awarded as a guarantee that personal data are processed in compliance with EU standards)

Towards robust, inclusive regulation specifically for microfinance

Developing economies need to encourage greater domestic production and entrepreneurship within the country in order to reduce poverty indexes. Since the beginning of the last century, microfinance has proven itself to be the most efficient way of channeling financial resources to the parts of the population excluded from formal banking services: enterprising people who can set up and manage micro enterprises.

In Latin America and the Caribbean, microfinance has been the most efficient, most sustainable way of helping people escape the poverty trap[1]. Nonetheless, if we wish to continue to combat poverty through economic development driven by microfinance, we need a competitive regulatory and supervisory environment that helps entities servicing the productive activities of the unbanked population to grow responsibly.

Regulating an economic sector only makes sense if the regulations take its particular characteristics into account. Each industry and each market segment will have peculiarities that require made-to-measure responses from the regulator. If regulation is slapped on without sensitivity towards the differences between the composite parts of the market, it can end up exerting far too much pressure on some and insufficient pressure on others.

Finance is a complex industry. It requires different standards for the different types of financial services that it provides. An obvious example is retail banking and investment banking. These are not comparable, since retail banking takes the public's deposits and investment banking does not. So

although there may be grounds for regulating investment banking[2], the requirements regarding capital, provisions and reserves cannot be the same as those applied to retail banking.

The microfinance industry provides small sums of money to people with low incomes and entrepreneurs wishing to develop small enterprises. Its scope of operation is highly specific. Consequently, the microfinance has to work in a highly specific way too.

Microcredits are at the very heart of the microfinance industry. They are targeted at low-income brackets of the population (often operating in the informal sector or underemployed) and to people wanting to establish small businesses. In general, the customers of microfinance entities are concentrated in specific geographical areas, which tend to be eminently rural or still underdeveloped) or specific social strata (the least well-off. Due to their geographical location, their social characteristics or the size of their businesses, the potential demand for microcredit tends to come from those encountering difficulties in obtaining finance from retail banks. Microfinance involves small amounts of money, with relatively short repayment terms and no liquid collateral.

Analyzing micro-credit risk is a complex, decentralized activity, because many microfinance customers live in rural or semi-rural areas, do not have a credit history or can not even show proof of their income, which is likely to come from undocumented sources. Their credit risk analysis has to largely rely on the work done by commercial agents who can go out and visit the customers at their homes or workplaces and help them fill in the forms needed to give them access to funding.

The regulation and supervision of microfinance entities requires in-depth knowledge of the business model that such entities employ. The Microfinance Workstream of the Basel Committee on Banking Supervision[3] has specifically recognised this. If regulators do not have the necessary insight into how the microfinance system works, their regulatory policies can only be based on their experience of traditional banking. This could lead them to impose excessive costs on the microfinance industry, discouraging investment in this vital financial sector.

Certain aspects of the financial industry are considered to require an approach that can focus on the particular issues of the entities involved in providing microfinance. The requirements regarding aspects such as capital and liquidity requirements, the assessment of credit risk, operational risk, provisions and reserves are highly specific to this industry.

Of all these aspects, perhaps the most relevant are those relating to credit risk and operational risk.

In the microfinance business, the customer profile, product design, credit placement methodologies and, in general, its core business model, have to be based on the existence of very specific risks. The regulator must understand the specificities and know how to manage the tools used for their identification and quantification, and not be content to simply apply the regulatory tools conceived for traditional retail banking. For example, although the regulator must require the microfinance entities to submit written credit policies, these must contain some flexibility to deal with the real situation of the market segments they are meant to be targeting. Decentralised credit analysis, decentralised pay-out, the use of alternative collateral instruments, and group loans are all likely to form part of these policies as standard practices that although unusual in traditional banking, have to be commonplace in the microfinance business model by dint of its very nature.

Likewise, regulatory requirements on contract documentation must take into account that the bounded-rationality problems besetting retail banks are enormously accentuated in the microfinance segment. Thus it makes no sense to oblige microfinance entities to disclose sophisticated information or include clauses in their contracts that have nothing to do with the products being offered to their customers.

With regard to operational risk, regulation must acknowledge that the tendencies and practices in the microfinance sector differ significantly from those of retail banking. Different regulation is required to adapt to operational and internal-control policies tailored to a highly decentralised process for granting microcredit. It should also take into account that the operational risk associated to commercial advisors is the microfinance entities' biggest single risk, as these advisors' business is quite different from those of the staff selling traditional banking products. Similarly, given the high degree of decentralisation and deconcentration of the segment serviced, the regulations must facilitate the use of new information technologies to enforce regulatory standards, such as remote supervision systems (pre- and post-disbursement), control systems and reporting systems.

Right from the outset, microfinance has enabled certain vulnerable sectors of the population world-wide to escape from the indignity of poverty. Without the microfinance industry, millions of people all over the Earth would simply not have the possibility to access funding. Of course regulation is necessary, as the microfinance entities take funds from the public. However, to apply the same qualitative and quantitative rules to these entities as are applied to the retail banks may have a seriously adverse impact on the growth of this financial sector. It can generate the imposition of inefficient compliance costs if it fails to take into account the business model or the size of the enterprise. It could also lead to high concentration in the sector, as the smaller entities, unable to bear the burden of such compliance costs, simply give up the struggle.

There is thus a clear-cut argument in favour of the need for adaptation, so that each jurisdiction has a regulatory and supervisory framework in keeping with the characteristics of the sector, promoting its development by ensuring a correctly targeted risk-management, with robust corporate governance and transparency in microfinance institutions.

Just as regulators have decided to regulate investment banking in the light of its specific characteristics, they must also adopt a specific set of regulations for microfinance. The regulatory framework should be informed by the real business model employed by the microfinance sector, so that it can be tailored to the size and type of credit transactions actually required.

In the BBVA Microfinance Foundation Group, we are working towards a better future for the people who are at present most economically disadvantaged. We aim to sow wealth by encouraging the growth of enterprises conceived by people currently excluded from the formal economy. We are convinced that microfinance is a force that can drive forward a society's development. Thus, within the framework of our mission, we want this publication to benefit all the stakeholders in this industry. We aim to facilitate the information required to reach informed decisions that can encourage the healthy growth of this sector and provide key assistance in the fight against poverty. Accordingly, this issue of Progreso discusses the recent Microcredit Regulation approved by the Monetary Board of the Dominican Republic as well as other legislation enacted in the different jurisdictions of Latin America and relevant for the microfinance industry.

[1]As demonstrated by the World Bank statistics: 77% of people escaping poverty have done so through individual initiative.
[2]Investment-bank regulation is not based on the need to protect public savings as such. Rather it is a way of controlling systemic risk, which could be triggered by non-compliance with obligations hedged through investment-banking derivatives.
[3] Microfinance Activities and the Core Principles for Effective Banking Supervision (2010).

Low-volume consumer credit

The Ministry of Finance & Public Credit in Colombia published a decree on 17th December 2014, creating a new line of credit for low amounts, called “el crédito de consumo de bajo monto”.

Under this decree, such low-volume consumer credit is granted exclusively to finance individuals. The maximum term will be 36 months, and the maximum amount of the transaction will be two minimum monthly wages. Under the current legislation at 2014 prices, this would be COP 616,000; approximately US$ 268.

The specifications for this line of credit are: i) It cannot be a rolling credit line; ii) It cannot be offered over credit cards; iii) The lender must first verify that the customer does not have an outstanding debt balance of more than two monthly minimum wages; and iv) The lender must define maximum repayment terms and instalment frequencies.

The regulation does not establish any more than a very general framework for the approval of such lines of credit. It leaves this to the discretion of the lender. Colombia is expecting the financial watchdog, Superintendencia Financiera, to put out some standards for them, especially with respect to how the risk on such credit should be managed.

Over-indebtedness is a shadow that always hangs over the microfinance industry, especially when it is providing lines of credit for consumers without any specific purpose. This decree was intended to expressly establish the requirement that lenders must first check the borrowers’ overall borrowing balance before allowing them to make any drawdown against these low-volume lines of consumer credit. In order to be able to get a precise estimate of such balances, the financial institutions must establish a methodology that will take into account the payment obligations that the potential borrower currently has with the financial sector and other sectors. For this, they will have to use the information filed at the financial information central offices for such purpose.

The decree is trying to regulate a kind of credit that already has some antecedents in mechanisms for offering small amounts of credit, for example in order to buy household appliances, which were settled in the accounts of some public services or through department store cards. Recognising such practices, it has expressly highlighted the importance of including a way of avoiding over-indebtedness so that borrowers cannot accumulate more small debts than they can afford.

Specialist Electronic Payment and Deposit Companies

As the first issue of this publication went to press, the Congress in Colombia held the final reading of the Bill 181-S/2014, debating the final details regarding Specialist Electronic Payment and Deposit Companies, known as Sociedades Especializadas en Depósitos y Pagos Electrónicos or SEDPES. On 21st October 2014 it passed Act 1735/ 2014, setting forth measures to promote access to transactional financial services and establish other provisions.

This act creates the figure of SEDPES, defining them as financial institutions with the exclusive

mission of: i) Raising funds through electronic deposits; ii) Making payments and transfers; iii) Taking loans inside and outside the country for the specific purpose of funding their transactions; and iv) Sending and receiving money orders.

Some significant changes were brought into the text as it went through parliament, although the bill maintained its core purpose of creating new financial service companies with an exclusive mission, whose constitution would be subject to less demanding requirements.

The act makes it clear that SEDPES are not allowed to grant any kind of credit. They must comply with all provisions applicable to the entities under the oversight of the Superintendencia Financiera, with respect to money laundering and the financing of terrorism.

The SEDPES may be constituted by any individual or organisation, including operators of postal services and providers of telecommunication services and networks, as well as public home services, following verification of certain conditions. The act incorporates the possibility of financial-service companies holding an interest in SEDPES' equity. It includes provisions empowering SEDPES to provide their financial services through correspondent institutions. And finally, recognising that a large percentage of the users of such entities will be of limited resources, it establishes that the transactions carried out in SEDPES' deposits will be exempted from the tax on financial movements[1].

The final version of the bill tackles the issue of data protection and processing, establishing that a SEDPE may exchange data-base information within its group holding.

In summary, several aspects of importance came up during the parliamentary debate. Those mentioned were timely inclusions to achieve a more suitable regulatory framework for these new types of entities.

[1] The tax on financial movements (Gravamen a los Movimientos Financieros or GMF) is a national tax in Colombia on transactions made on some financial products (current accounts, savings accounts in certain cases, etc) and on certain financial transactions (credit disbursement, management cheques, debits to collective investment funds, some fx payments, etc). It is currently 40 basis points for each unit of value in the transaction.

Transparent information to financial service consumers

Following in the footsteps of countries such as Chile (Act 20555); Mexico (Act on the transparency and regulation of financial services); Peru (Act 28587), on 26th December 2014 the Colombian Congress approved Act 1748/2014, establishing the obligation for financial institutions under the oversight of the Colombian financial supervisor, Superintendencia Financiera de Colombia, to inform their customers not just of the interest rate effectively paid or collected, but also, where the nature of the product or service permits, the Total Unified Value (valor total unificado or VTU) for all the items that the customer actually pays or receives on their loans and deposits. The new regulation also makes it mandatory for these institutions to provide customers with a VTU projection before they sign a contract, where appropriate to the product or service being arranged, so that they know in advance how much they will be effectively paying or earning on their money.

VTU will be the consolidated value of all the items linked to the financial product or service. This will

include, amongst other aspects, interest payments, insurance premiums, charges, contributions, expenses, fees, taxes, etc.

The value must be expressed as an effective annual percentage for the expected term of the product, and as an absolute figure in Colombian pesos. It must be given the same publicity as the interest rate related to the product or service being offered.

Apart from this, the act also includes provisions regarding financial services provided by the Pension Fund Managers working under the individual savings regulations.

It is important to note that within no more than 90 days after the enactment of the law, the Colombian government will have to regulate the form and periodicity with which the entities under the supervisor's oversight must present the information. At the moment there is much debate regarding the financial methodology by which customers and potential customers will be presented with the VTU. The entities will be forced to introduce significant changes not just in the financial methodology they use to report their products' yields and costs, with the impact this will have on their IT systems, but also the way they market their offerings, since it is not advisable to overload potential consumers with information they do not really need, use or understand. It would be positive if all financial operators, and not just those within the remit of the financial supervisor, were obliged to provide the price of the products they offer in the manner established by this act. This would not only improve the probability of the impact that this legislation seeks actually materialising, but would also avoid regulatory arbitrage between unregulated and regulated operators.

Integral Reform of the Law on the Banking System for Development

Last November, the Legislative Assembly of Costa Rica adopted Act 9274, ovehauling the earlier Act 8634 regulating what is known as the "Banking System for Development" ("Sistema de Banca para el Desarrollo"). The main objective of the reform is to encourage more funding for feasible, profitable projects, in line with the country's development model.

The act includes definitions of the system's goals, its beneficiaries, and its regulatory supervisors (the Consejo Rector and the Technical Secretariat). It also identifies three sources of funding for the system:

Fideicomiso Nacional para el Desarrollo, administered by a public bank following instructions from the Consejo Rector.
Fondo de Financiamiento para el Desarrollo, a fund for financing development. Each bank must have its own fund, administered by the banks themselves.
Fondo de Crédito para el Desarrollo, a fund for providing development credit. Set up with contributions from all the Costa-Rican banks, it is administered by a public bank (more specifications laid down in the law's subsequent implementing regulations). The Consejo Rector will indicate to private-sector banks what percentage they must transfer to the administering bank by way of contributions to this fund.

Previously, the legislation did not specifically regulate the microcredit industry, so what is new in this law is its explicit recognition of microcredit's importance for inclusion and development.

The act also deals with the regulation of the following aspects:

It defines microcredit borrowers as subject to the regulations of the Banking System for Development;
Projects funded by microfinancial entities through microcredit will be given priority treatment.
It encourages the simplification of information requirements in credit dossiers.

It establishes schemes specifically to help small and micro businesses to flourish: the special fund for the development of MSMEs (Fodemipyme) and a support programme for SMEs (Propyme), to finance activities promoting and improving management and entrepreneurial skills. It also obliges the National Apprenticeship Institute (Instituto Nacional de Aprendizaje) to contribute 15% of its budget to financial-education programmes providing technical assistance and training and skill-building programmes.

Costa Rica's government is making an outstanding effort to promote a framework for robust growth of the microfinance industry by strengthening the Banking for Development System. In the future, it should consider giving publicly-run banks a lower profile in order to leave room for more active participation from the private sector. This would generate greater efficiencies and benefit from best practices in other countries of the region.

Transparency in Microfinance Transactions

In order to promote transparency in microfinance transactions, on 26th May 2014 the National Assembly of Nicaragua approved a new regulation, "Norma sobre Transparencia en las operaciones de Microfinanzas" which repealed the regulation on information transparency from the previous year, "Norma sobre Transparencia de la Información", 2nd August 2013.

The new legislation firstly regulates the content, scope, dissemination and delivery of contracts signed with Intermediary Financial Institutions, to guarantee their transparency and clarity and avoid any clauses that could be damaging to users' interests. Secondly, it establishes the means for calculating and disseminating the information on rates, fees and expenses charged to borrowers.

Although it does not bring about any substantial modifications with respect to the regulation it repeals, it considerably broadens the range of protection given to people using microfinance services.

Specifically, it imposes more stringent rules on minimum conditions and content that must be stipulated in contracts, adding nominal interest rates and the requirement that the contract be written in the customer's native language or tongue when financial institutions are located in autonomous regions. It also forbids changes in the current interest rate if not expressly agreed beforehand as a variable.

The range of infractions classified as sanctionable have also been expanded. Some examples of what are now minor infractions: not handing over proof that the policy includes the customer under collective insurance cover and not providing the public with a credit simulation. And any action that may prevent customers from repaying their loan with the intention of pushing them into arrears is now typified as a serious infraction.

Finally, it introduces an obligation for microcredit intermediaries to organise financial education campaigns to inform users about the concept and aim of the effective annual cost rate, known as the TCEA (tasa de costo efectivo anual) and establish means to disseminate these.

The new regulation takes a decisive step forward in establishing a specific regulation for the microfinance sector, which had been badly hit by the economic recession as well as the political instability besetting the country between 2008 and 2011 (the “no pago” movement encouraging non-payment).

Over the last three years a comprehensive package of regulations has been enacted specifically for microcredit, and a specific regulator set up to supervise the sector. This demonstrates the existence of an environment that is propitious for further development of the microfinance industry.

Prevention of Money Laundering and Terrorist Financing

Executive Decree 947, 5th December 2014, reorganises the Financial Analysis Unit for the Prevention of Money Laundering and Terrorist Financing, in order to align it with international standards. These include the establishment of national financial-intelligence units to receive and analyse reports on suspicious transactions.

The decree establishes the Financial Analysis Unit (Unidad de Analysis Financiera or UAF) as a state security body, under the umbrella of the Ministry of the Presidency. The amendments to its duties are mostly related more to their form than their content. These duties include:

Providing Financial Intelligence Report to the public administration when an investigation should be started. This used to be the duty of the National Public Prosecutor’s Office.
Carrying out strategic analyses to determine patterns, risks and types of behaviour related to money laundering. This must be shared with the supervision and control bodies, the public administration and the national police.
Keep statistics on movements of cash and quasi-cash and on suspicious transactions.
Organisation and conservation of the files obtained in the performance of its duties.
Represent the state at the Financial Action Group and assist the financial and non-financial regulators.
Share financial intelligence information with similar security bodies abroad is maintained. The decree now adds that information may also be shared with jurisdictions that do not have specific agreements with Panama, provided they belong to the Egmont Group.

The regulation is focused on restructuring the administrative management of the UAF. It includes the requirements that the Director and Deputy Director must meet to qualify them for their positions, and some modification to their duties. It establishes that the unit must work closely with the High-Level Presidential Committee for the Prevention of Money Laundering and Terrorist Financing and tasks it with the actions agreed by the international bodies to which Panama belongs.

Previously this Committee only acted as an advisory service for the Republic’s president. It was reorganised under Executive Decree 948, 5th December 2014.

Having a legal framework in line with international standards strengthens the financial sector. It helps to improve the country’s image and performance with respect to preventing money laundering and the financing of terrorism. It should keep Panama off the list of non-cooperative jurisdictions.

Customer Care Services

Last 11th September 2014, the Banking, Insurance and Pension Fund Supervisor, Superintendencia de Banca, Seguros y AFP´s, adopted Circular G-176-2014 on Customer Care Services, in order to have tools enabling greater control over the financial-customer care service, which was then amended on 31st December that same year. The main obligations that the Circular establishes for financial institutions include:

Implementation of manuals for queries, complaints and information requests;
Quarterly reporting on complaint performance;
Dissemination of statistical data on the website regarding complaints most frequently presented by users;
Filing of quarterly statistical data with the supervisor, SBS, regarding complaints, to presented within fifteen days after the end of each natural quarter; and,
Preparation of an annual training plan for the staff dealing with the public's complaints and/or queries.

These obligations will impose higher costs on the financial institutions, while the benefit for the users is not especially clear, as the reporting required of the institutions is mainly intended for the regulator. The information is statistical in nature, leading some to question just how helpful it will really be to users, who are usually more concerned about the non-statistical aspects of their finance.

Analysis about Microcredit Regulation of the Dominican Republic

Martín Naranjo

The Microcredit Regulations approved by the Monetary Board of the Dominican Republic in August 2014 were an important step forward for the microfinance industry in the region. The document was drawn up following a broad-ranging consultation with the country's financial authorities and financial institutions, as well as multilateral organisations and other expert bodies and individuals. It reflects local and international expertise and best practices, synthesising them into a set of regulations well suited to the industry´s objectives.

The regulations clearly define the specifications, limits, requirements and responsibilities relating to microcredit. They also give detailed criteria for the assessment and classification of borrowers' eligibility and the risk categories and provisions associated to such loans. They also detail the

mechanisms for implementing the internal models for managing risk on the microcredit portfolios.

The regulations define a microcredit as credit that is: (i) requested by persons with their own small-scale business or activity producing revenues or invoicing up to RD$6m (US$136k) a year; (ii) intended to fund production, marketing or service activities; and (iii) whose principal source of repayment is the proceeds from the sales and revenues generated by such activities. In order for a loan to be considered a microcredit, it must also meet other specifications: (iv) the term should be 1 year or, exceptionally, 3 years; (v) the instalments should be paid every 30 days or less; and (vi) the borrower's consolidated debt should not be more than 40 minimum wages.

The regulations of most South-American countries run along similar lines. Practically all of them define microfinance as a way of funding production, marketing or service activities. This is the case in Argentina, Chile, Colombia and Peru. It is also usual to limit the total amount of consolidated debt, although the limits vary. They are set at US$50k in Panama; 120 minimum monthly wages in Colombia (~US$35k) and ARS60k (~US$7k) in Argentina; while in Peru the limits are PEN20k (~US$6.7k) for micro enterprises and PEN300k (~US$100k) for small enterprises. Panama or Peru do not specify any definition of borrowers. In Argentina, the borrower's total assets are limited to a total of 50 basic baskets; in Chile the borrower must be classified as among the 50% most vulnerable in the total population. And in Colombia, micro enterprises, small enterprises and medium enterprises are defined according to the number of workers: 10, 50 and 200, respectively; and by the value of their total assets: 500m 5k and 30k minimum monthly wages, respectively. (The minimum wage is defined in the prevailing legislation).

It is important to bear in mind that any definition of microcredit has the unenviable task of categorising a heterogeneous, constantly changing sector. A legal definition, or even just a working definition, must somehow manage at the same time to be sufficiently broad and sufficiently restrictive. Broad, so that it will not exclude micro enterprises, and restrictive in order not to include sectors that fall outside the scope of such regulation.

It makes sense for regulators to opt for simplicity, breadth and flexibility. They must recognise that the costs of unnecessary exclusion tend to be greater than the costs of misguided inclusion. Moreover, the costs of compliance and supervision increase in parallel to the complexity of the regulation; and a straitjacket can introduce discontinuities that have real effects on the dynamics of wealth creation among the population that can benefit from microfinance. Obliging the microcredit borrowers to comply with requirements regarding their income, total assets and consolidated debt, and demanding that the credit term, rates and instalments meet specifications, could bring in constraints which, if applied across the board, would establish a complexity that made compliance more difficult and, above all, the job of the banking supervisors extremely arduous.

For example, verifying consolidated debt imposes a burden on the supervisor and on the industry as a whole. They must both coordinate their information on borrowers and manage it in a suitable manner. This will become more difficult, there are delays in disseminating the consolidated information. And apart from debt, on the income side, verifying the revenues of micro enterprises also entails significant extra work for the supervisor, which will have to validate the methodology used to report income in somewhat informal business settings. In order to have a regulation that can be enforced efficiently and transparently, the supervisor must tailor supervision procedures to focus on how suitable the methodologies are, and the capacity of intermediaries to successfully use and control the methodologies required of them.

The challenges of dealing with intermediaries in this context are contemplated in the articles on responsible risk management, microcredit risk management and the credit information system. These establish that entities must manage risks with an infrastructure and control function in keeping with their nature, size, complexity and risk profile. The Regulation makes the board responsible for

supervising compliance and the senior management responsible for the application of risk policies. It also requires a specific unit to take responsibility for managing microcredit risk, with well-defined duties and sufficient independence. The banking authority (Superintendencia de Bancos) approves the microcredit risk management model for each entity.

The Dominican regulations correctly emphasise the importance of the borrower's payment behaviour or track-record as a key element in determining the risk associated to each transaction, and require detailed records in the dossier drawn up for each borrower. However, they include the possibility of using digital or partially digitalised files for this. This helps everyone. The intermediaries' storage costs and the search times can be significantly lowered. And digitalisation will also enable the supervisor to exercise remote oversight and reduce time spent on site-inspections.

The document allows the roll-over of loans to business units that have met up to 75% of their debt obligations, without having to reclassify to a higher risk, provided there is no impairment in their conduct. What the legislator is trying to avoid is the possibility of letting borrowers with outstanding loans simply repay those loans by taking out new ones. However, this has to be offset with the common practice in micro enterprises of taking out loans on longer terms than they need, as an implicit liquidity insurance. They then often end up repaying the loan ahead of schedule and taking out further loans for new amounts almost at the same time. It is hard to establish the common threshold, because the problem is not fixing a parameter. For the intermediary the problem is one that needs to be dealt with through implementation of admission and monitoring policies. And for the banking supervisor, it is a problem of evaluating the criteria and supervising the admission and monitoring capacities of the intermediary.

Another interesting element is the reclassification of the portfolio. The Dominican regulations establish that when the banking supervisor sees fit to increase the risk ratings for more than 5% of the loan portfolio reviewed in its inspections, the intermediary must set aside additional provisions for deficiencies in their classification of risks according to a table. This can mean up to 2% additional provisions for discrepancies of over 30%. It thus becomes important to identify sources of possible discrepancies in advance. Specifically, because the Regulations classify borrowers by days in arrears and demands one sole classification per customer. They take into account the consolidated debt held by each borrower in the entire system. If the classification is based on days in arrears, then this should be done automatically.

The Dominican regulations consider collateral to be a secondary element in managing microcredits, and it is not taken into account either in the classification of the borrower or in the constitution of provisions. Despite its effect on expected loss, it is reasonable to exclude collateral from the provision calculations as in the micro enterprise sector, when there is collateral, it is nearly always from informal guarantees, and is hard to realise and even harder to set a value on.

The document also forbids the payment of fees up-front and compensatory balances. The borrower can redeem the loan early without any penalties, and the financial institutions may not establish any condition that forces the borrower to deposit part of the microcredit in a specific account within the lender's bank. The Regulations are clearly trying to protect borrowers from predatory practices. But at the same time, they make it impossible to develop financial-inclusion products that use balances in savings accounts associated to the microcredit as a form of education in the use of savings products. These type of products would have to be re-defined in order to comply.

The Dominican regulations are an important step forward in laying down the right kind of banking standards. They reflect best regulatory practices and experience gathered from other jurisdictions, while at the same time taking advantage of the definitions and expertise made available to them by leaders in the Dominican microfinance industry. This ability to strike a balance can also be seen in the management of intermediaries and, especially, the management of banking oversight. However good regulations may be, they are not much use if they cannot be supervised and enforced. There is little point in extrapolating criteria from the oversight of traditional banking and slapping them onto the

microfinance industry. The regulations must recognise that this sector has a different mission, a different scale and that its incentives are also different. Its efficiency requirements are resolved differently and its systemic risks are quite different from the traditional banking industry.

Thus, the Dominican regulations also require a significant investment for the supervisor. In order to achieve compliance with the regulations, the supervisor must ensure it has an adequate oversight strategy. This will mean modifying its organisation and its allocation of human and financial resources, as well as its systems. The success of these new regulations largely depends on the Dominican supervisor's ability to live up to this challenge.

Importance of Mortgage Loans for the Agricultural Sector

A bill has been put before the Colombian Congreso de la República that would add two paragraphs to article 2455 of the Civil Code in order to facilitate access to mortgage loans for livestock and arable farmers.

The proposed legislation aims to make it possible to constitute more than one mortgage against the same property asset, without needing to divide it up or break it down prior to the constitution and / or filing of the encumbrances.

This is a novel initiative that would allow farmers to have easier access to finance, even when the property asset has already been mortgaged, without the earlier mortgage encumbrance discouraging potential lenders willing to put up the finance.

To understand the background to this, it is important to understand that in Colombia, although it is possible to take out more than one mortgage against the same property asset, mortgages are ranked by seniority, which reflects the order in which they were filed. This means that the first-degree lenders, ie, those that granted the first mortgage, have more senior claim to repayment than the subsequent mortgagers. The other lenders may only pursue what is left over once the first-degree lender has received repayment in full.

In tackling this situation, the proposed legislation benefits both lenders and borrowers in the agricultural sector. For the lenders, the initiative would mean de facto elimination of the senior versus the more junior ranking. No one mortgage lender's claim would be any "better" or "worse" than the others'. Lenders could thus make a better assessment of the mortgages, so that they are better placed to increase their offer of finance accordingly. For the farmers, it would mean greater access to finance, especially when they need to request several loans for smaller sums than the value of the asset they are using as collateral.

Another key aspect is the possibility to realise the collateral without, in principle, prejudicing the other mortgage lenders. In effect, if the Congress of the Colombian Republic passes this law, it will allow a lender whose borrower has not repaid their debt, to realise their collateral by dividing up the mortgaged asset for a sum equivalent to the amount used to underwrite the loan.

This, then, is an initiative that will encourage greater access to finance for farmers, as the financial institutions will have more interest in offering them credit once they have more guarantees that collateral on loans to this sector will be realisable. Likewise, the farmers will be able to take out loans from more than one financial institution when they need to do so

Elimination of minimum installment for home loans

Act 546/1999 established the general framework and standards regulating home loans in Colombia. Amongst other aspects, it tried to encourage more buyers for both newly built and second-hand homes, as well as to boost the number of new homes built. These were laudable goals, especially at the end of the last century, in a context in which Colombia was trying to tackle the consequences of a financial crisis that had to some extent been caused by an imperfect mortgage market. However, the act did not go far enough for the home owners that needed an affordable mechanism to finance improvements to their homes, as they had to access other lines of credit to do so, which were usually more expensive than mortgage-based loans.

This bill is intended to make up for this gap in the legislation, by extending the application of Act 546 to lines of credit requested for the funding of owner-occupied home refurbishment, repair or improvements. It would also allow such lines of credit for a term of less than five (5) years, provided home-owners' creditworthiness makes this financially feasible. The bill would incorporate the possibility of presenting collateral other than a mortgage for cases in which the home loan is for the refurbishment, repair or improvement of the owner's home.

Additionally, the bill includes a provision that "in view of the borrower's repayment capacity, and verifying the conditions established in section number 9 herein, mechanisms will be establish to finance individual home loans that will allow for funding of up to one hundred per cent (100%) of the property's value". This aspect should be carefully analysed by the legislator and by the financial industry. At first sight, one might think it would facilitate access to home loans. However, it will be vital to avoid people taking on more debt than they are able to repay. In this sense, the bill does not make it clear under which conditions it would be feasible for a borrower to finance their home with 100% leverage.

A 100% Loan-to-Value Ratio in Colombia, where practically all loans have a 70% LTV, will mean that additional collateral may need to be required, over and above that of the property whose acquisition is being financed. This is something that lenders should study in depth. Their involvement is important, as they have experience enabling them to understand what impacts such a measure could have on the Colombian housing market. Nobody should forget that excessive housing credit leverage, without due mitigation measures, was one of the causes of the latest international financial crisis.

Encouraging the grant of home loans

The purpose of this bill is to: i) Authorise entities to grant home loans; ii) Permit authorised entities access to the Reserve Fund for Mortgage Portfolio Stabilisation (Fondo de Reserva para la Estabilización de Cartera Hipotecaria or FRECH)[1]; iii) Place all the entities under the oversight of the financial watchdog, Superintendencia Financiera de Colombia (SFC); and iv) Oblige the entities to earmark between 10% and 25% of their gross loan book to the financing of construction,

refurbishment and acquisition of social housing (Vivienda de Interés Social or VIS) during the 15 years following the approval of the law.

The key aspects of the bill are related to the inclusion of new entities empowered to grant mortgage loans; and their obligation to include lending from their total available credit for construction, refurbishment and acquisition of social housing.

Allowing new entities to give mortgage loans may help to avoid regulatory arbitrage, but care should be taken to ensure that all the lenders meet the requirements for current lender institutions, eg, with regard to the risk management systems, in order to avoid uncertainty regarding the sustainability and fairness of home loan placement.

An obligation on lenders to earmark a minimum percentage of their loan book to funding VIS acquisition would seem to ignore the freedom of enterprise enshrined in the Colombian constitution. Under this principle, there are now several financial institutions in the country lending in very different niches. Some target micro enterprises, others the retail sector, etc. The have thus become experts in managing credit risk for those specific markets, but not necessarily for the housing market.

If the bill is to create another kind of lending that will be mandatory for the financial institutions, it will be important for it also to include other compensation to offset the obligation, such as mortgage bonds or mortgage warrants originating from the securitisation of the social-housing loan portfolio.

[1] The Fondo de Reserva para la Estabilización de la Cartera Hipotecaria (FRECH) is a fund created under express authority from the Colombian housing act, Act 546/1999. It provides an interest rate hedge intended to facilitate the funding of social housing in urban areas through loans for purchasing or renting homes. The hedge is a swap, calculated against the interest rate agreed for new loans or new home-rental contracts granted by lenders to borrowers meeting the legal requirements. The hedge will only be applicable during the first seven (7) years of the credit, counted from the date of disbursement or from the date on which the home rental contract came into forcé. FRECH is administered by the Colombian Central Bank, Banco de la República

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Consumer Rights Protection

Act 19496 on Consumer Rights Protection regulates relations between suppliers and consumers, establishing which actions may be deemed harmful to consumers and what procedures should apply in this area. It gives powers of oversight to the Spanish national consumer service (Servicio Nacional del Consumidor or SERNAC), which can also impose fines. It also encourages more robust public involvement in consumer-related matters.

The main changes in the law are as follows:

i. SERNAC will be empowered to enforce the law; impose fines under administrative proceedings resolved by SERNAC’s regional director; lay down general instructions and standards; interpret and apply regulations and, finally, use collective mediation as a preliminary step prior to taking cases to court.

ii. It stipulates that consumer associations may enter into civil and mercantile contracts to finance their business. This allows them to engage in profit-making activities.

iii. It increases the amounts of fines for infringing consumer protection legislation.

iv. It extends the statute of limitations for actions stemming from breaches by suppliers from 6 months to 2 years.

The bill aims at protecting consumer rights, by alloweing SERNAC to apply harsher measures in the event of failures to respect the principles of protecting customers' interests.

Encouraging financial inclusion through an alternative payment system

The use of an electronic payment system, such as credit and debit cards, is widespread in Chile and elsewhere in Latin America. Many countries in the region make it necessary to hold a bank account and be able to prove appropriate capacity for debt repayment in order to use them.

This bill aims to encourage financial inclusion by allowing non-bank entities to issue payment instruments following prepayment by the holders, who can then pay using cards, internet accounts, mobile telephones or any other support.

This bill places companies issuing such payment instruments or operating such payment systems under the oversight of the country's financial watchdog, Superintendencia de Bancos e Instituciones Financieras. It also stipulates that they will be subject to the Financial Analysis Unit (UAF) and the legal provisions on money laundering.

These prepay systems do not require consumers to enter into a formal relationship with the issuing entity, thus keeping issuance and operation costs down.We consider that this makes such systems easier and more affordable for users and encourages people often excluded from the formal economy to engage with the financial system.

Crowdfunding legal regulation and other financing systems

Following the financial crisis in Spain and its impact on corporate capital and equity, the legislature is trying to establish more efficient funding for businesses. This bill thus aims to: (i) make bank borrowing more affordable and more flexible for SMEs; and (ii) regulate more novel funding methods, such as crowdfunding and crowdlending, which fund projects over technology platforms by multiple investors, without the involvement of traditional banks.

Regarding bank finance, it adopts measures such as:

Obliging lenders to give notice before any line of finance to an SME is terminated or reduced.
Requiring financial institutions to prepare a mandatory credit report for the SMEs and show it to them.

This must be drawn up with information of standardised quality and with a uniform method, established by the supervisor.
Facilitating access to funding for Mutual Guarantee companies through an improvement in the legal standards that allow such companies to capitalise the counter-guarantee granted by the Spanish Counter-guarantee Company (Compañía Española de Refianzamiento).
Establishing the legal framework for Financial Credit Establishments (Establecimientos Financieros de Crédito);
Introducing further measures to enhance the transparency, quality and simplicity of securitisation issues in Spain, and
Eliminating caps on bond issuance.

For the first time ever in Spain, the bill attempts to establish a regulatory framework for a world in which people's lives and businesses are ever more engaged with new technologies, and raising finance for projects over participative funding platforms is increasingly common. Crowdfunding has shown itself to be a dynamic economic driver in countries such as the United States, which already has crowdfunding legislation, as do the UK, Germany and France.

Thus, the Bill targets those activities whereby investors seek an economic return either by taking out shares or a stake in the business (crowdfunding) or by putting up a loan (crowdlending). Such lending is a core activity for the microcredit industry, working online with borrowers.

The Bill regulates the legal framework and permits required from the government authorities to establish platforms (the CNMV securities commission and the Bank of Spain). It also seeks to protect investors, recognising that this is an intrinsically risky activity in which there is little guarantee of the solvency or feasibility of the project in which they are investing. The Bill includes measures establishing the type of information that should be made available to the investor and caps the overall amount of money invested, depending on whether it is made by an accredited investor or not. Accreditation is a function of the investor's wealth or income. The Bill also emphasises the transparency that must be built into the system to deal with possible conflicts of interest that may arise in such activity.

Personal data treatment in public registries

On 11th December 2014 the lower chamber of the Paraguayan parliament passed a bill amending Act 1969/02, regulating private information.

This bill regulates the processing of personal data included in archives, registries, data bases or any technical medium containing public or private data intended to issue reports, in order to enforce their holders' rights.

The bill amends articles 5 and 9 of Act 1969/02, which establish, firstly, in which cases the data on a person's wealth and commercial and financial obligations can be published (under the necessary condition of express, written authorisation); and secondly, prohibitions against the disclosure or dissemination of such data by companies or organisations providing information on banks' customers' wealth, economic solvency and/or compliance with their commercial obligations.

In the first reading in parliament, two significant amendments were put forward to the draft bill.

Borrowers with debts of below 50 minimum-wage days and all debts repaid would be eliminated immediately, and no record of the borrower's late payment would remain.

The final version of the bill only included the amendment regarding immediate exclusion from the data bases for borrowers that settled their debts, regardless of how long they took to do so.

The Chamber of Deputies also approved including positive data on borrowers that are up to date on their payment schedules.

Paraguay's Central Bank has criticised this bill in the media. It considers that it does not help the financial-inclusion programme defined by the Paraguayan government. Specifically, the PCB predicts that the bill's provisions will restrict credit and make it more expensive, since lenders will not have sufficient information to evaluate the risk for loan requests.

Oversee savings and credit cooperatives

This legislative initiative places Savings & Credit Cooperatives (Cooperativas de Ahorro y Créditos or COOPACs) under the direct supervision of the Superintendencia de Banca, Seguros y AFP. These cooperatives had not previously fallen within the scope of the supervisor's remit.

At present the COOPAC are supervised by the National Federation of Savings and Credit Cooperatives of Peru (Federación Nacional de Cooperativas de Ahorro y Crédito del Perú or Fenacrep). This organisation is made up of the COOPACs themselves, and membership is voluntary. Its mission is more one of support than regulation, as it provides defence, technical assistance and training services. It does not exercise oversight. Consequently, the COOPACs lack robust corporate governance policies and their management systems are not always suitable for tackling the kind of risks to which they are exposed.

With this proposal, the Superintendencia aims to amend the current model of oversight for the COOPACs and provide real safeguards to depositors entrusting funds to them. If the proposal prospers, these depositors will be protected in the event of bankruptcy or liquidation of the COOPACs. The protection would be backed by an independent Cooperatives Insurance Fund parallel to the Deposit Insurance Fund, and one single registry for these Cooperatives, so that the Cooperatives System can grow more healthily.

Personal information inclusion in Public Registries

In the field of personal data on creditworthiness and financial solvency and its filing in what is, commonly known as the "registro de morosos", the Spanish Supreme Court has handed down a ruling on the litigation between a security services company and some individuals affected by the inclusion

of their personal information on the registry where credit history and financial solvency data are filed. The Court ruled that such inclusion, in order to be considered legitimate and not to infringe the accusing party's rights to honour, should comply with Spanish legislation and, in particular, with Organic Law 15/1999, 13th December, on Protection of Personal Data, and the provisions contained in its implementing regulations. Fundamentally, it indicates that personal data filed with the registry must be true and exact, as well as decisive in judging the economic solvency of the interested parties.

The Supreme Court, basing its arguments on its jurisprudence, establishes that companies may not use the threat of being filed in the financial solvency registry as means of coercion to claim back possible debts, taking advantage of people's fear of personal discredit and the difficulty of accessing formal credit once one's name is filed in the registry.

Likewise, the input of people's information into the registry must respect European regulations on personal data. This fundamental right is contained in article 8 of the European Union's Charter of Fundamental Rights and Directive 1995/46/EC, 24th October, by the European Parliament and the European Union Council. This set of EC regulations broke new ground when enacted and laid the foundations for the configuration of a system guaranteeing protection of personal data in all the different domestic legislations of the European Union member states.

Duty to provide customers with adequate information

The possible failure of a financial institution to comply with the duty to provide customers with adequate information on a specific financial product initiated legal proceedings that concluded with a ruling from the Supreme Court of Spain.

The Supreme Court, in view of the domestic and EC legislation, and specifically the Securities Market Act and Directive 1993/22 of the European Union Council, emphasises that the obligations of financial institutions include providing customers with clear, correct, exact and sufficient information on the service or product they are considering taking out. The Court has also stated that such information must be given in sufficient time to avoid its incorrect interpretation.

It also emphasises that customers must be informed of the characteristics of the products, and that special attention and diligence must be displayed when dealing with non-professional customers.

Although there are specificities relating to the country, the financial institution, the product and the customer in the ruling, the guidelines established by the Supreme Court reflect international tendencies in the area of customer protection, which the microfinance industry should incorporate due to the special vulnerability of its customers.

The Principles of Customer Protection set forth by the BBVA Microfinance Foundation Group are part and parcel of its system of Corporate Governance. They reflect a firm commitment to a line of action. In this way, the Group is promoting two fundamental principles, in keeping with the arguments of the Supreme Court:

The Duty of Diligence in two senses. Firstly, the products designed and marketed by the entities belonging to the Foundation Group should not be complex and must be easy for its customers to understand. Secondly, member entities are obliged to help customers avoid over-indebtedness by offering financial products that are suited to their needs.

The Principle of Transparency. The Foundation Group supports this principle, ensuring that its customers must be provided with clear, pertinent information that is sufficient to be able to understand its products, apprising them of their rights and obligations so that they can take informed, well-grounded decisions.

By way of demonstrating the Group's commitment to transparency, as part of its Entrepreneur Training project, it has created an educational dossier that it intends to distribute among its customers along with the rest of the contractual information. Its aim is to ensure they can master the core concepts of financial education (what a microcredit is, what an interest rate is, fees and charges to be paid, etc).

National Financial Inclusion Strategy

The document "Estrategia Nacional de Inclusión Financiera 2014-2018 (ENIF)" was presented on 2nd December 2014 in Paraguay. The report laid down the guidelines for the government's nationwide development strategy, a vital part of the drive to achieve full financial inclusion by 2030, established under the National Development Plan.

The strategy in based on an analysis of the current state of financial inclusion in the country, using the results of the 2013 financial-inclusion survey, Encuesta de Inclusión Financiera (EIF). It identifies realistic targets and establishes a coordinated action plan involving the public and private sectors and civil society, in order to reduce poverty and boost economic growth in Paraguay.

The report sets forth four objectives to be met by 2018:

Reduce the financial vulnerability of households at the foot of the socio-economic pyramid.
Attain more widespread provision and uptake of financial services in a secure, competitive market.
Help economic development and growth by giving MSMEs and larger businesses greater access to financial products.
Promote financial inclusion, striking a balance between the interests of the financial sector and consumer education and protection.

It identifies five groups in the population (people living in extreme poverty; living in less extreme poverty; people with an average income; with a medium-high income and with a high-income) and studies the demographic and financial profile of each, along with their specific financial servicing requirements.

The strategy sets up seven groups to work on different aspects of finance, in order to meet these requirements and comply with the four main objectives of the strategy plan. These are the Savings, Credit, Insurance, Payments, Financial Education, Consumer Protection and Vulnerable Populations Working Groups.

Under Decree 1971/14 the Comité Nacional de Inclusión Financiera was set up to boost financial inclusion, under the umbrella of the ENIF. It comprises representatives of the Paraguay Central Bank (BCP), the Ministry of Finance (MH), the National Cooperativism Institute (INCOOP) and the Technical Planning Secretariat (STP).

The last section of the report includes a list of the forty nine (49) tasks in the action plan. It ranks

them by priority, deadline and the group responsible for their roll-out.

The Miracle of Financial Inclusion

Reynaldo Marconi's book, El milagro de inclusión financiera: La industria microfinanciera de Bolivia (1990-2013) [The Miracle of Financial Inclusion], provides a comprehensive analysis of the inclusion process, the development, promotion and consolidation of the microfinance industry in Bolivia.

It provides the reader with a detailed comparison between the 1993 Financial Institutions & Banks Act and the Financial Services Act of 2013. The author describes the transformation that has been brought about in the country, with analytical insights into the current environment in which these latest microfinance policies are being implemented.

Reynaldo Adán Marconi is an economist by profession and has worked on various technical and executive aspects of microfinance. His positions in the microfinance industry have included those of executive secretary of the Specialist Microfinance Entities' Association in Bolivia (ASOFIN), founding member and president of the Credit Information Bureau (INFOCRED BIC S.A) and founding member and president of the Latin-American and Caribbearn Rural Finance Forum (FORO LAC FR).

Inequality and its impact on economic growth

This report Cingano, F. (2014), "Trends in Income Inequality and its Impact on Economic Growth", OECD Social, Employment and Migration Working Papers, No. 163, OECD Publishing, studies income inequality and how it can have a sizeable and statistically negative impact on countries' development.

The analysis shows the importance of a two-prong strategy to tackle inequality and promote access to public services for the entire population:

It recommends that governments take a new look at their legislation and try to increase taxation for high-wealth brackets and eliminate or reduce the deductions from which these brackets benefit. It advises they implement mechanisms to promote and facilitate universal access to public services (universal health systems, education, etc).
It establishes a set of measure to promote investment in human capital. The study looks into the way income inequality makes it harder for people in the lower-income brackets to access education, especially quality education.

Social and economic evolution in Latin America

The Economic Commission for Latin America and the Caribbean (ECLAC) presented its report on "The Social Panorama of Latin America 2014" at the end of January. The study has been drawn up since the beginning of the '90's and provides a broad-ranging analysis of the most outstanding economic and social aspects of the Latin-American countries, tracking their performance over time.

This year's report bases its conclusions on the economic data gathered in 2013 and during the first quarter of 2014. It shows that, despite the important economic growth in the region over the last decade, which was above the world-wide average, poverty and inequality have scarcely moved from their 2011 and 2012 levels.

In order to contribute to a more comprehensive design of public policies aimed at overcoming poverty and socioeconomic inequality, the report focuses its analysis on : (i) youth and development, (ii) gender inequality in the labour market and its impact on socio-economic inequality and, finally, (iii) urban residential segregation and the reproduction of inequalities

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Corporate Governance Legislation

Proposal on the amendment of the Corporate Governance Regulations, made by the banking supervisor, Superintendencia de Bancos de República Dominicana. Resolution Six, 30th October 2014.

The initiative to review the prevailing Corporate Governance Regulations, approved by the Monetary Board under Resolution Two, 19th April 2007, recognised the continued evolution of best international practices in this area. The banking supervisor wanted all stakeholders to have a say on the proposal, and published it with the stated aim of bringing the regulations into line with the Basel Committee for Banking Supervision's Principles to enhance Corporate Governance, October 2010, and use them to add stability and robustness to the regulatory system.

The proposal, which is now in its public consultation period, contains several changes to the earlier regulations. These include the following:

Inclusion of the fundamental principles of Corporate Governance, which provide guidelines for establishing best practices. Henceforth, companies' internal regulation must expressly incorporate issues such as the protection of shareholder rights; independence, transparency and objectivity of board of directors proceedings; procedures for managing and dealing with potential conflicts of interest; management oversight; succession planning, etc.
Incorporation of new definitions (Senior Management, the Assets & Liabilities Committee (ALCO), Interested Parties), and the classification and definition of different types of directorships, distinguishing between external directors –whether independent or proprietary– and internal directors (executive members).
Addition of powers for the members of the board of directors: to approve the Internal Board Regulations, approve the strategy plan and policies of the entity, enforce good corporate governance, management and risk control, outsourcing of functions, etc.
A longer interim before a Board Member can be considered independent. Two years must now elapse

after the termination of labour or business relations with the company, rather than the earlier 6 months.
Requirement to provide Board Members with a minimum of 20 hours a year specialist training.
Obligation for the Board of Directors and Senior Management to carry out a self-assessment.
The attribution of duties to the various committees assisting the Board, determining that all of them must be chaired by independent external directors. Also the inclusion, for the first time, of an Integrated Risk Management Committee and a description of its duties.

There are some proposals that catch the eye. For example, the mention of an upper age limit for directors. More recent trends in Europe and in international companies try not to restrict the age of directors, giving prevalence to the contribution each can bring to the entity with their experience and knowledge. (See Código de buen Gobierno Corporativo para las Sociedades Peruanas, Peru 2013; Código de Mejores Prácticas Corporativas (Country Code), Colombia 2014; Comisión de Expertos en materia de Gobierno Corporativo, Spain 2013; EU Corporate Governance Framework, EU Green Book 2011).

It no longer requires that the Board of Directors contain a minimum proportion of independent members, as stipulated in the 2007 regulations.

The proposal would require a significant additional workload for banks and financial institutions, which will have scarcely 90 days after the Regulations are published to comply with them

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Personal Data Protection

In the last decade personal data protection has become particularly relevant throughout the world. Latin America has been no exception. Several Latin-American countries have updated their legal systems to guarantee the rights of individuals over their personal data.

With similar content to laws passed in Colombia and Peru, this law provides a set of principles and tools for comprehensive protection of personal data, whether stored in files, public records, databases or other public- or private-sector technology platforms. It also provides mechanisms guaranteeing individuals' right to honor and privacy.

This law also regulates the establishment, organization, activities, operation and liquidation of credit bureaux known as SICs (Sociedades de Información Crediticia), which are engaged in collecting, organizing, storing, holding, communicating, transferring and/or transmitting data on consumers, goods or services related to them, and any other information provided by the banking regulator, using automated or manual procedures, in hard-copy, digital or electronic format. The databases of these entities will be integrated with the information provided directly by the contributors of data on lending and other similar transactions that these give their consumers, in the form and terms in which it is received from the contributors of data and any further information provided by the banking supervisor or other public entities.

To guarantee that people can exercise their rights over their personal information, the law creates a procedure that begins with the information owner being able to submit a claim to the database owner, to update, contrast, rectify or destroy information as well as disciplinary proceedings for entities that fail to comply with the law's provisions.

Anti-money laundering

This law incorporates the latest recommendations of GAFI, the FATF-style Spanish financial action task force set up by the government to implement international anti-money laundering standards, placing domestic Spanish regulation at the forefront of international best practices, by including the very latest international demands.

The main new feature is the further ramification of the “risk-based approach” that is already established under current law, incorporating the requirement of regulated entities to analyze the main risks they face, in accordance with the type of business, product or customer with which they establish business relationships. On the basis of this analysis, regulated entities have certain obligations of a procedural nature, to ensure a match between the internal policies and procedures and the risk profile of the respective entity.

The law also allows the State Tax Department (Agencia Estatal de Administración Tributaria) to request and obtain the information that regulated entities hold or manage, on the grounds of diligence obligations contained in the law. It also gives the regulated entities discretionary powers to check out the professional or business activity declared by its customers through personal visits to the places where they carry out their business activities.

Customer Protection

This act transposes regulatory changes in European law into Spanish statutory law by bringing together in one act regulations applicable to credit institutions in areas such as supervision, capital requirements and penalties.

This legal measure thus establishes a single legal framework on solvency and access to the activity of credit institutions, bringing together legislation previously scattered over various different regulations, some very old and all prior to the global financial crisis. It regulates the general aspects of the system enabling lenders to be certified as credit institutions, as well as the operation of its governance bodies, their supervisors and sanctions that can be applied by the authorities, as well as establishing capital and solvency requirements and appropriate risk management.

The inclusion of Article 5, regulating the protection of credit-institution customers is particularly striking. This article empowers the Ministry of Economy & Competitiveness to issue pre-contractual rules on information to be provided to customers, so that they “explicitly and most clearly” reflect the rights and obligations of the parties and the risks stemming from the service and/or product, so that customers are able to analyze whether or not it fits their needs. The Ministry, within the powers granted, may establish basic conditions for banking services and products that must be duly complied with by entities. It also specifically regulates that fees or expenses can only be charged for services that have been “expressly requested by the customer”.

In reaction to the excesses generated prior to the economic crisis, this law empowers the Ministry to issue rules to ensure that credit institutions perform more robust risk analysis when granting loans.

Lenders will be encourage to pay due attention to the customer's income, the adjusted value of their collateral, the impact of potential changes in interest rates on variable-rate loans, etc. Ultimately the idea is to achieve greater rigour in risk assessment.

Additionally, and in order to avoid the application of arbitrary rates against which variable-interest loans are indexed, the Ministry itself or through the Bank of Spain can now regulate these indices in an official capacity.

Finally, all provisions of Article 5 are reinforced by their treatment as organizational and disciplinary regulations of credit entities, which are thus subject to the supervision of the Bank of Spain and the penalty system reflected by these regulations.

Institutions specializing in electronic payments

Over recent years in Latin America, e-money payments have been on the rise, and the Colombian government is encouraging the use of institutions specializing in the creation of e-money and conducting transactions using e-payment systems, in order to promote the development of products and services to facilitate financial inclusion through electronic devices.

Bill 181/2014 is currently going through Colombia's Congress. Unlike other such initiatives elsewhere, such as in Peru and Uruguay, this bill is not focused on regulating "electronic money", but rather grants a simplified financial license to new companies specializing in electronic payments and deposits , which must comply with some of the rules applicable to traditional financial institutions in order to be able to attract funds from the public and make drafts, transfers and payments using electronic systems.

Microcredit acces

Through this Bill, the Colombian Congress seeks to oblige banking institutions to offer preferential microcredits for setting up small businesses. This Bill sets minimum percentages for how much microlending must be provided by all institutions in the Colombian financial system.

Its provisions include, (i) cost-free processing of credit applications; (ii) assessment and granting of microcredit subject to the applicant's business plan, and not to the provision of collateral; (iii) monitoring by the Colombian government of the growth of the microcredit loanbook; and (iv) implementation of programs to promote access to microcredits in the rural sector.

The text of this Bill is identical to that of two previous Bills (Bill 43 of 2013, Chamber, and Bill 218 of 2013 on Microcredits), which were rejected during the corresponding legislative debate and subsequently shelved.

Bank accounts for minors aged between 14 and 18

In order to imbue Peruvians with a savings culture from an early age, the Executive has proposed that minors aged between 14 and 18, should be able to open bank accounts. Bank accounts are exclusively for depositing and withdrawing the money they receive from their parents or from third parties as pocket money or small rewards.

This system would only include savings accounts in local currency. Only male and female minors aged between 14 and 18 may be the individual holders of such accounts, and shared ownership is prohibited.

The Bill is currently being debated at Committee stage in the Congress of the Republic.

Bill for a Secured Transactions Act

As part of the package of measures for economic recovery, the Executive has proposed this Bill with the aim of reducing costs in secured transactions by movable assets and extending the scope of such security, in order to facilitate access to credit.

The main amendment proposals include: (i) creation of a Virtual Public Registry to replace the current Movable Property Contracts Registry; (ii) cost-free access to the Virtual Registry; (iii) immediate foreclosure of collateral without the need to inform the debtor through a notary public; and (iv) the possibility of performing legal acts relating to the collateral through e-mail notifications.

This Bill is currently under review at Committee stage in the Congress of the Republic

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Google and the personal data processing

In relation to the protection of individuals in the processing of their personal data and the free movement of such data. With respect to a dispute between Google Spain, S.L. and Google Inc., on the one side, and the Spanish Data Protection Agency and Mr Costeja González, on the other, the Court has resolved that necessary measures should be taken to remove personal data from their index and thus prevent future access to such personal data.

Thus, when as a result of a search conducted using the name of an individual, links to websites containing information on that person are offered, he or she may contact the search engine manager directly or, if the latter rejects the request, contact the relevant authorities so that those links are deleted from the list of results, under certain conditions.

New Country Code and Implementation Report

The Code of Best Corporate Practices – Country Code, published through External Circular 028/2014, will contain 33 measures with 148 recommendations on: (i) Rights and Equitable Treatment of Shareholders, (ii) General Meeting of Shareholders, (iii) Board of Directors, (iv) Control Architecture, and (v) Transparency and Financial and Non-financial Reporting. The Code's structure will be based on the "comply or explain" principle and its recommendations are voluntary for securities issuers.

For each recommendation, issuers must describe how they have implemented it or why they have not done so. On the first occasion of reporting a recommendation, the institutions must specify the date on which it was adopted.

The Country Code establishes that the institutions' bylaws must describe their compliance, and the compliance of their directors and employees in general, with the recommendations adopted and how it is monitored. It also sets out the institutions' duty to submit the results of the implementation report to the Annual General Meeting.

Code of Good Corporate Governance for Peruvian Corporations

Under this directive, the SMV (the Peruvian securities exchange commission) seeks to ensure that the Corporate Governance information disclosed to the market complies with the new standards set out in the Code of Good Governance for Peruvian Corporations that came into effect in November 2013. Thus, the Annex to the Annual Report referring to "Information on Compliance with the Principles of Good Governance for Peruvian Corporations" is replaced with the "Statement of Compliance with the Code of Good Corporate Governance for Peruvian Corporations". In this report, listed Peruvian companies must inform the market each year of the level of compliance with the recommendations made in the Code of Good Corporate Governance, based primarily on five aspects: (a) Shareholder rights, (b) General Meeting of Shareholders (c) Board of Directors & Senior Management, (d) Risk & Compliance, and (e) Transparency of information.

The drafting of this Code is part of a wider process to reform the Peruvian capital market, intended to create a robust culture of Corporate Governance in Peru that improves investor perception of

companies, promotes business development and contributes to the creation of value in the Peruvian economy.

New Regulations on Secured Transactions

Following in the steps of Peru, Chile and Uruguay, the new regulations overhauling the previous secured transactions system came into force in Colombia in February 2014. This new system streamlines the mechanisms to create, record, and foreclose guarantees on movable assets and thus eliminates some antiquated pieces of Colombian legislation prohibiting creditors from seizing assets directly from their debtors (under the so-called pacto pignoraticio or “pledgee agreement”).

The new legislation is based on the OAS Inter-American Model Law on Secured Transactions and the UNCITRAL legislative guidelines. Its benefits include the centralization of information in a single registry administered by the Confederation of Chambers of Commerce, which not only make it possible to file the security or collateral, but also to find out the creditworthiness of persons standing guarantee, thus providing more information to lenders and reducing the cost of access to credit.

Economic and Financial Literacy Commission

Economic and financial literacy is one of the top priorities of the Colombian government. As in other countries in the region (Uruguay and Peru, for example), a National Commission is being created under this law, comprising various influential public-sector bodies, such as the Ministry of Finance and the Colombian financial supervisor, as well as private-sector entities. Its mission is to establish policy, guidelines and tools for implementing the National Strategy for Economic and Financial Literacy.

The involvement of financial institutions in this Commission is vital to its success, given their accumulated expertise and knowledge and their ability to measure the effectiveness of the economic and financial literacy policies established by this Commission. Also noteworthy is the progress in financial inclusion, opening up access to finance for a segment of the population traditionally at a disadvantage and not catered to by the financial system.

Modernizing the Secured

Transactions System

This law adopts a mechanism fully in line with market realities. It establishes new rules regarding the mortgaging of movable assets, thereby amending Decree 2/1955, 24th May, which was very useful in its day, but fell into disuse as market requirements changed.

This standard, which was inspired by the OAS Inter-American Model Law on Secured Transactions, seeks to facilitate access to credit by extending the categories of secured transactions to the mortgaging of trade receivables; stocks and shareholdings in any kind of corporation; inventories; property rights; copyright, etc. It streamlines the system of transactions secured by moveable assets, establishing simplified registration procedures; faster implementation mechanisms and the possibility of successive mortgages, as well as eliminating the unnecessary red tape only too common for this type of operation.

The rule benefits both parties (lenders and borrowers), who, apart from increasing their range of mortgage options, can access operations faster and at lowers costs. This will definitely make banking more attractive. It will also give a boost to the country’s competitiveness as it upgrades the system to meet international standards.

Access to the Microfinance Sector

This law represents a breakthrough in the field of Microfinance as it introduces a prudential regulatory framework based on risk-management; prudential regulations and international accounting standards. This strengthens the oversight of regulated companies, of vital importance, since the country’s financial institutions (apart from the banks) and Non-Governmental Organizations had previously failed to meet international standards on these matters.

Furthermore, a definition of microcredit has been introduced for the first time, distinguishing between microcredit and other types of financing on the basis of the risks involved. The law also focuses on the use of credit technology by microfinance institutions and determines the minimum standards they should use.

Electronic Money

In order to improve access to finance among the segment of the population most disadvantaged and not traditionally catered to by the banking industry, in January 2013 the Congress of the Republic of Peru adopted a law on electronic or e-money (Act 29985). This established a minimum regulatory framework for the use of e-money as a payment method, filling an obvious legislative gap on this matter. Its aim is to promote the development of products and services that facilitate financial inclusion, under conditions of safety, transparency and reliability for the benefit of the population.

It regulates a range of matters, including the issuance of e-money; the companies authorized to issue it; the basic specifications and requirements for e-money transactions (payment for goods, conversion

and reconversion of e-money, transfer of funds, etc) and contractual requirements for them.

To ensure the safety and reliability of e-money, the law has restricted its provision exclusively to entities under the scope of supervision of the financial oversight system and mainly to those registered as mobile-banking providers. In a country like Peru, where the population is scattered over a wide area and mobile-phone penetration is the highest in the Latam region, the use of (cellular) mobile technology to provide touchpoints for accessing financial services would not only considerably reduce transaction costs but also eliminate entry barriers into the financial system.

Regulating Electronic Money

This decree provides in-depth regulation of the operating procedures for electronic money transactions, as well as the main aspects of the e- money issuers (known by their Spanish acronym as "EEDE" or Empresas Emisoras de Dinero Electrónico.

It defines electronic money as a monetary value stored on an electronic device for the sole purpose of payment (payment system). It also sets out that the principal platform for performing any e-money transaction is the cell phone (mobile technology).

In order to operate with electronic money, customers must hold a bank account and use it to make payments and order transfers… This restriction is intended to boost security and reliability in e-money transactions, since it is more likely that systems operated by entities under the oversight of the financial regulator will properly process e-money transactions. And it also seeks to improve levels of financial inclusion, given that customers who perform simple e-money transactions and become familiar with this process are more likely to request other financial products or services.

Multisector Commission on Financial Inclusion

Empirical and analytical evidence on the positive relationship between financial development and economic development indicates that one of the obstacles to economic development is the population's limited access to financial services. In this respect, financial inclusion has become a top priority for the current government in Peru.

It has thus set up a Multisector State Commission responsible for designing and implementing the National Strategy for Financial Inclusion ("ENIF") under this decree, to make financial products and services more accessible to lower-income brackets, enabling them to break away from the poverty and exclusion they face at present.

This commission comprises representatives of the Ministry of Economy and Finance (MEF); the Ministry of Development and Social Inclusion (MIDIS); the banking, pension-fund and insurance supervisor (SBS); the Central Reserve Bank of Peru; and Bank of the Nation

The decree details the duties of this Commission and the procedures for its formation and articulation.

Transparency of information

This latest amendment to the regulations on transparency of information and contracts with financial system users is intended to oblige financial institutions to justify the level of fees and bank charges agreed with customers.

Thus, fees must be based on proven and effective provision of an additional service supplementing the core service to which the customer has signed up. It is noteworthy that, as a result of this Regulation, financial entities in Peru can no longer charge fees for the provision of services deemed to be “inherent” to the financial product or service taken out. For example, these entities may not charge for creditworthiness assessments, as these are an inherent part of financial intermediation.

Enhance corporate governance in Corporate Enterprises

Act 31/2014 was adopted to amend the earlier Corporate Enterprises Act in order to enhance corporate governance within the framework of the Committee of Experts’ Report on Corporate Governance. It has included nearly all their recommendations.

The act introduces other changes apart from the amendments described in our previous issue (Progreso 1). Of special importance is the section on the annual report and the annual corporate governance report on director remuneration (articles 540 and 541).

Article 540, Informe anual de gobierno corporativo, establishes the obligatory nature of an annual corporate governance report for publicly listed companies. This must be filed with the Securities Commission (CNMV), which will determine its content and structure. The report must provide a detailed explanation of the entity’s corporate governance and how it works in practice. Should the listed company be a European company, it must not only file the Spanish annual report but also another report drawn up by the board regarding oversight of its performance of duties.

Article 541, Informe anual sobre remuneraciones de los consejeros, obliges the board of directors in listed companies to prepare and publish a report on director remuneration each year. This must include the remuneration directors receive for their directorships and, where applicable, the remuneration they receive for executive duties. The information provided must be comprehensive, clear and understandable. It will be disclosed as a relevant event filing, presented alongside the annual corporate governance report. The report filed will be put to a consultative vote at the General Meeting as a separate item on the agenda. However, the Ministry of the Economy & Competitiveness or the CNMV are expressly empowered to determine the content and structure of the report.

Electronical payment systems and financial Inclusion

This legal provision, as in other countries in the region (Colombia and Peru), seeks to ensure financial inclusion of disadvantaged segments of the population and those who have not been traditionally catered to by banking. It sets forth measures on:

Establishing mandatory payment of wages and pensions through a bank account using debit cards or e-money (prepaid cards) in the formal financial system
Free opening and maintenance of accounts for workers and SMEs
Granting “payroll loans” that can be deducted from wages
Reduction in value-added tax for card payments
Restrictions on cash payments
A savings program for house purchase
E-money Issuers

Aspects highlighted in this law include constraints on the use of cash, expressly prohibiting its use in certain business transaction, such as the sale of goods or services for a sum equal to or above $5,000 if one of the parties meets the law’s specifications, and in certain transactions with the State.

Prohibiting the charging of compound interest

Act 18.010/1981, on rules for credit operations and other monetary obligations, sets out that: “Payment of interest on interest payments may be stipulated, and may be capitalized at each maturity or renewal date. Under no circumstances may such interest be capitalized for periods of less than thirty days”.

There are currently two Bills aimed at eliminating these abusive practices. Both are parliamentary initiatives not sponsored by the Executive. One aims to eliminate compounding of interest absolutely and the other aims to eliminate compounding and the clause for shortening terms in financing and refinancing transactions. Both proposals are part of the ongoing efforts seen in recent years in relation to consumer rights protection, particularly in the financial sector.

Financial and Insurance

Information

In May 2014 the Congress of the Republic of Peru approved a legal measure facilitating access to financial, pension and insurance information for legal probate.

As a result of this now statutory provision, legal heirs can obtain the information on life insurance policies, private-sector pension funds and deposits or other financial products, which appears on the certified copies of death certificates.

Thus, certified copies or filing information of death certificates issued by the offices of the National Identity and Civil Status Registry (Reniec) include summary and reference information to apprise heirs of the existence of due procedures and a legal framework under which they may exercise their rights.